Volume II
Subcommittee Reports

REPORT OF THE AD HOC COMMITTEE ON CITY FINANCES

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REPORT OF THE AD HOC COMMITTEE

ON CITY FINANCE

VOLUME II

This Volume contains the reports of each of the four subcommittees of the Mayor's Committee on City Finance. These subcommittee reports were prepared for and used by the full Committee in arriving at its conclusions and recommendations set forth in Volume I. They are reproduced here for the purpose of amplifying points made in Volume I and highlighting areas of concern identified by the individual subcommittees which are not fully reflected in Volume I.

VOLUME II

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I

REPORT OF THE SUBCOMMITTEE ON THE NATIONAL MUNICIPAL FINANCIAL CRISIS

January, 1976

To: Mr. J. Howard Edgerton, Chairman
Ad Hoc Committee on City Finances

We are pleased to submit to you and the full committee the attached report of the subcommittee on the National Municipal Finance Crisis.

Respectfully submitted,

Edmund G. Brown, Sr.
Barbara Seaver Gardner
Ignacio E. Lozano, Jr.
Chauncey J. Medberry III
Joseph R. Rensch
Maurice J. Dahlem, Chairman

MAYOR'S AD HOC COMMITTEE ON CITY FINANCE

REPORT OF THE SUBCOMMITTEE ON THE NATIONAL MUNICIPAL FINANCE CRISIS

This subcommittee has been charged with reviewing the circumstances surrounding the New York City fiscal crisis for the purpose of developing a basic understanding of its causes in order to draw some meaningful conclusions about the differences and/or similarities between Los Angeles and New York and the possibility of such a crisis occurring here.

We have found that the causes of the New York City fiscal crisis have been extensively documented with little disagreement on the findings.

As to Los Angeles' fiscal status our comments are based upon the following sources: data published by Los Angeles City, recent articles on the municipal finance crisis, information furnished us primarily by the office of the Chief Administrative Officer of the City in answer to our questions, and information obtained by Messrs Rensch and Dahlem of our subcommittee when they served on ad hoc committees appointed in 1974 and 1975 by the Mayor to consider the economic development needs of the City and the adequacy of financial controls over its disbursements.

This report was prepared and made available to all members of the Special Committee, in January, 1976, prior to the completion of the field work of the other subcommittees and without the benefit of their findings and views on the economic health of the City, its current revenues structure and alternatives and its expenditures.

SUMMARY AND CONCLUSIONS

This summary and the conclusions that follow should be tempered by an important consideration. Los Angeles, like New York City or any other city, is not an entity unto itself. It is a part of the total governmental structure and its health and its ability to stay healthy are strongly affected by the activities of county, state and federal governments as well as the private sector.

The New York situation -

In a nutshell, New York City's financial problems and cash flow crisis which have led it to the brink of bankruptcy came about because the city became committed to more expenditures than it could afford. In large part, this was the result of yielding particularly over the past ten years to pressures for increased expenditures for a wide variety of social, welfare and other services and agreeing to demands for costly wage and benefit increases. At the same time, sources of revenue were being driven out by the high costs of living and doing business and by social problems. During this ten-year period, New York did not squarely face the revenue deficiencies caused by its

increasing costs of operations but rather resorted to gimmickry and short-term borrowing which eventually precipitated the current fiscal crisis in that city. Significantly, cash expenditures for operating expenses and capital improvements of New York City exceeded cash receipts in the fiscal years 1973-74 and 1974-75 by $2.0 and $0.8 billion, respectively, necessitating borrowings which increased short-term debt to $4.9 billion and long-term debt to $8.4 billion at June 30, 1975. By this date, the City had no cash balance and had been denied access to the bond market.

Whether all the efforts in recent months by the City, State and Federal governments, union pension funds and others to provide emergency cash funds will head off default on New York City bonds remains to be seen. In the long run, the financial stability of the city hinges on its ability to balance its budget, convert a major portion of its short-term debt into long-term debt and expand its tax base in proportion to its service (or shrink its services in proportion to its tax base).

In order to focus on the question of "can a New York crisis happen in Los Angeles", we are listing below the ten key factors, as we see them, in New York City's dilemma, and relating them to the present situation in Los Angeles with a look at the future here:

1. Acquiescence to pressures for more public service, with concurrent deficit spending for operating expenses -

   Decisions were made by New York City over a long period of time to undertake widespread, expensive social and other programs and increase its work force without

providing for the required revenues. In simple words, an inability or unwillingness to live within its revenues.

Parts of its public policy on social service include:
...the city university's tuition-free and open-admission policy for high school graduates, which now costs over $612 million a year, up from $42 million fifteen years ago;
...subsidized housing for low- and middle-income tenants;
...rent control policies which have led to the deterioration and subsequent abandonment of some 30,000 rental properties, with delinquent property taxes amounting to $220 million in fiscal year 1975;
...costly transportation subsidies and the low-fare policy; and
...expanded health facilities beyond city needs, with $800 in health cost per person on welfare and a hospital vacancy rate of 25 per cent.

2. Expenditures for programs dictated by state and federal governments -

   Responsibility for welfare and health care services dictated by the state and federal governments falls upon New York City because it operates as both a city and county. New York is one of only twenty-one states that requires its local governments (e.g., counties) to contribute to the support of cash assistance for the aid of families with dependent children program or to Medicaid payments. Of these twenty-one states, the local share is the highest in New York, where it amounts to almost one quarter of the total or half of the nonfederal share.

3. Unsound fiscal practices, such as:

   Operating expenses were classified as part of the capital budget, thereby funding current expenses with the long-term debt incurred for capital purposes;

   The repeated overestimating of revenues and underestimating of expenditures;

   Inaccurate recordkeeping, inadequate financial controls and improper accounting principles; and

   The absence of the requirement for an annual independent audit of city finances.

4. The abetting of the City's deficit finance policy by the State of New York:

New York State "assisted" or abetted New York City in its current problems by:

a. Passing legislation enabling New York City to engage in unsound financing. As a single example, in 1964, the state passed legislation permitting the City to borrow against the Mayor's estimate of revenue the City would receive in the coming fiscal year (previously, the borrowing was limited to the revenue received in the previous year). No provision was made in the law that specified how the borrowing would be repaid if the Mayor's estimates turned out to exceed the actual receipt of funds.

b. The state mandated programs with only initial, if any, funding for New York City.

5. Elected officials of New York City mortgaged the future -

The elected officials in New York City apparently yielded more than others to a policy of mortgaging the future to solve current fiscal problems. From 1967 to 1974, the city's short-term debt grew by $4 billion, a shocking increase of 700%. As a result, in fiscal 1974-75, New York City's expenditures for debt service amounted to 15% of total expenditures.

6. Migration -

Over the years, there was an exodus of middle class wage earners and an influx of poor minorities. Since World War II, roughly 2 million middle class wage earners have been replaced by poor minorities.

The exodus of middle and upper class wage earners from the city to suburbs outside the city resulted from a number of factors, including

a. decay and obsolescence of the inner city coupled with increase in crime and erosion of law enforcement,

b. fewer available jobs in the City (during the period 1970 to 1974 jobs in the private sector declined 10% to 2.8 million) and

c. better living conditions in suburban areas and good transportation facilities into New York City.

The influx of unskilled poor and minority groups was accentuated by the substantial migration from Puerto Rico, and by New York serving as the port of entry for most

immigrants to America, for which it is not reimbursed. This resulted in increased social and welfare problems and their related costs.

7. Erosion of job and property tax bases -

   This resulted from a number of factors, including

   a. the exodus of industry and commerce with a decrease in total jobs provided by the private sector,

   b. the exodus of middle and upper class wage earners discussed in 6. above,

   c. the effects of rent control which caused physical deterioration and necessitated widespread redevelopment and

   d. omission from the property tax base of all properties owned by nonprofit organizations regardless of use.

8. Costly concessions to city employees -

   Costly concessions were made to organized municipal employees in the form of (a) generous salaries and work conditions which apparently added employees without commensurate productivity increases, and (b) extravagant pension benefits, coupled with inadequate funding of such pension costs.

9. Temporary borrowing for capital projects -

   Temporary borrowing was secured for capital expenditures, awaiting better long-term markets; meantime this debt has been continuously rolled over at successively higher interest rates.

10. Impact of the 1973-75 recession and inflation -

    The recession-inflation combination, that was in large part responsible for a sharp rise in the cost of city services and welfare expenditures, contributed at the same time to the deterioration of city revenues, based more heavily on sales and income taxes rather than on property taxes as in other local governments. It also triggered New York City's loss of normal entry into the bond markets.

A New York writer in searching for an answer to the question, "Who's to Blame for The Fix We're In", concluded:

"If the principal actors who have guided our city's destiny these last several decades--Wagner, Rockefeller, Beame, Lindsay--seem the chief villains in this piece, it must be remembered that they could not have accomplished all they did without a supporting cast of state legislators, borough presidents, City Council members, and city comptrollers. Add to this list promiscuous bankers, voracious labor leaders and their members, and--by no means least--the press, because it was too preoccupied with gossip, too lazy, or assumed its readers were too dumb or too bored to bother with detail. Finally, there is the press's audience, the public, which all too often lived down to the press's low expectations. So, this is a story not only about what our "leaders" did--and how--but about what we did to ourselves."

<u>The Los Angeles situation</u>

There are significant structural, organizational, geographical and operational differences between Los Angeles and New York which up to the present time have helped to preclude the occurrence of a New York type crisis in Los Angeles. Key items in this respect are as follows:

Unlike New York, Los Angeles City does not bear the direct responsibility for social, welfare, education or medical services. The City is responsible only for services such as fire and police protection, sanitation, recreation, municipal planning, etc. The County handles the welfare, housing, criminal justice and hospital functions. Primary and secondary educational systems are controlled by the Los Angeles Unified School District. Higher education is provided for by the State of California or Community College Districts. Each is a separate independent entity with its own taxing power. Hence, Los Angeles City government provides only basic municipal functions and is responsible for a lesser array of services which mitigate the impact on the City budget of

heightened demands for additional increases in social or welfare services which plague New York.

Because of the greater area of Los Angeles City and its lower population density, the exodus of jobs and tax base that occurred in New York has not occurred to the same extent in Los Angeles since until recently the migration from the inner city and older portions of the city was in large measure within city limits.

City officials in Los Angeles have abided by the custom of balancing operating budgets with current revenues on a cash basis, supplemented by available or unexpended prior year funds, and have avoided the necessity of resorting to short-term borrowing in the private investment market.

The City government has made very limited use of long-term debt and has an excellent credit rating. In contrast to New York, Los Angeles is subject to more stringent bonding requirements by both the city charter and state law. Moreover, in California if the legislature mandates a program for local action then the law provides generally for the reimbursement of the local costs.

Los Angeles has for the most part resisted the path of fiscal irresponsibility in not yielding to a policy of mortgaging the future to solve current fiscal problems of an operating nature. While debt service expenditures in New York City in fiscal year 1975 amounted to 15% of total expenditures, debt interest and redemption in Los Angeles City amounted to only 3% of total expenditures.

Although the City of Los Angeles is in many ways dissimilar to New York City, the basic seeds of New York's problems exist here; some have already germinated and steps must be taken to limit their growth as well as stop new seeds from developing. Key items in this respect are as follows:

1. The pressure for increased services or expanded programs which characterize the New York City situation exist here in Los Angeles as well as in other major cities. For example, deterioration of the inner city, the changing nature of the city's population, high levels of unemployment (especially among minorities and the young) as well as other social problems have contributed to rising costs for basic services, such as police and fire protection. It has also resulted in a willingness on the part of the City to become increasingly involved with social and community type services which have traditionally been provided or handled by other agencies. Although such efforts are presently funded primarily with federal grants (model cities, CETA, and GLACAA programs), in the event the federal funds are withdrawn either in whole or part, serious financial problems could result if the City is unwilling or unable to make corresponding reductions in services and appropriations or increase revenues to offset the loss of grant funds. This is a potentially serious problem not only with grant funded social programs, but with all forms of grants which stimulate or support increased operating annual expenditures without the assurance of continued funding. For example, for the past few years the City has utilized

general revenue sharing funds to support operating costs. The initial general revenue sharing law is about to expire and there is some doubt as to whether it will be extended. As a result the City is in danger of losing significant operating revenues. As a further indication of future hard choices facing the City, federal measures, such as the clean water grant program which will provide a large percentage of capital costs required to upgrade the City's sewage treatment facilities, but no funds will be forthcoming to meet the increased costs of operating and maintaining new facilities after they have been constructed.

2. Los Angeles is already in the position of having made costly concessions to organized municipal employees. Los Angeles must not only engage in a "meet and confer process of collective bargaining" but, by Charter requirement, the City must first determine by survey the prevailing wages in the area, which wages become the floor from which collective bargaining begins. There is a view that the resultant wages and fringe benefits are now greater in many cases than those being paid in the private sector and that a more precise assessment of the total compensation packages provided by private industry should be made and applied to comparable positions in the City. Los Angeles also has inadequate funding of the police and firemen's retirement funds, using an unrealistic seventy-year period. In this connection the local press has carried stories in which (a) there was speculation that past underfunding of pension obligations in

Los Angeles is as much as $1 billion and (b) that in other governmental jurisdictions the heart of their problem is that labor costs have been rising in the last few years at a rate far exceeding inflation. Unless there is appropriate Council action regarding the Charter provision and a tougher and more realistic approach in the future to adjustments in employee compensation in total (wages, working benefits, retirement pay and other fringe benefits) and in pension funding, the financial problems in this area will escalate.

3. The preservation of the job base in Los Angeles has become a serious matter now with dismally high unemployment, particularly since Los Angeles today is no longer generally considered to be an attractive place to locate an industrial plant or other facility that provides employment. This is aggravated by the fact that the level of taxes paid by a business in Los Angeles is higher than in adjoining cities. There is also evidence that not only Los Angeles but the entire state of California is discouraging new employers from coming in and driving many present employers out. This is due not only to taxes but to very strict environmental and other government decisions, such as clean air and water regulations which are extremely burdensome on business.

A study made in 1974 by another ad hoc citizens committee appointed by the Mayor to study economic development of the City included a conclusion that Los Angeles "is experiencing the same economic and social life-cycle that older

cities of the world have experienced. The process first involves a growth phase, saturation, then stabilization followed by decline. Los Angeles appears to have reached a plateau of stabilization". The principal recommendation of the Committee that the City establish an office of economic development was approved by the Council and implemented in 1975.

Many issues affecting the economic well-being and job base of the City need to be addressed including energy requirements in the form of gas and electricity, redevelopment of the central business area, transportation, low income housing in depressed and declining areas of the City, and other matters. As an example, there is a view that a severe adverse impact on the City's job base will occur by 1979 or 1980 unless new supplies of natural gas can be brought in to replace declining existing supplies.

4. As to exodus, migration and immigration, Los Angeles has not served as a port of entry for immigrants to the extent that New York has, but it has had in influx of aliens - legal and illegal - from Mexico and other countries of Latin America, and a migration of the poor as well as that of the middle class from other areas of the United States, who have been drawn to our city by the mild climate and the prospect of better job opportunities. Moreover, the suburban areas of Los Angeles City are rapidly filling up and further exodus of upper and middle class wage earners from the central area will in many cases be beyond city limits, due to many factors including lower property

tax rates and less expensive housing in other cities and counties. Lastly, there has been discussion by various groups on the question of seceding from either Los Angeles City (San Fernando Valley) or from Los Angeles County (San Gabriel Valley); such efforts, if successful, would have a substantial impact on the tax base. What is happening here is part of the phenomenon of migration that is dividing the United States into two societies - one of inner cities populated by low income groups, including large numbers of Blacks, Chicanos and other minorities, the other of suburbs populated by affluent income groups, predominantly white with a small number of Blacks and Chicanos.

5. As to welfare and health services dictated by the state and federal governments, this is a county function in Los Angeles and accordingly no expenditures for such services are made by the City. However, to the extent that Los Angeles City shares the property tax base with the County and other taxing authorities, its revenue potential can be affected by the County's expenditures for welfare. In this respect it is good to note that Los Angeles County does bear a lesser share of total welfare costs (14.5%) than does New York City-County (23%).

With health, welfare and educational services being provided by the County of Los Angeles, the Los Angeles School District and other special districts that levy taxes against Los Angeles' citizenry, it is essential that they maintain their

financial stability and provide services at costs that the taxpaying public can afford. Our subcommittee considered that this matter was outside the scope of its charge and did not investigate whether they are doing so.

In this connection, we are concerned that new sources of revenue may be needed to cope with the ever-increasing governmental costs associated with the problems of the older inner cities of the nation, including Los Angeles. This may call for major changes in the present systems of taxation and allocation of costs as between governmental entities. We commend the effort of the Mayor and the City Council and other mayors to have Administration and Congress address itself to this issue. We would also hope that the Mayor and the City Council will press for concurrent attention at all levels of government to establishing and fostering a climate through tax incentives and more creative regulation for the formation of the additional new capital needed by this country for the modernization and expansion of its economic base.

Aside from welfare and health programs, there are other federal or state programs which may have a substantial impact on Los Angeles City's financial status. Matters of this type include the potential cost of compliance with earthquake resistance standards for buildings and other structures (such as dams) and with occupational, safety and health standards.

6. Unquestionably, Los Angeles has followed sounder fiscal practices than has New York City but, there can be no

complacency because there seems to be a recent tendency for Los Angeles to commit itself to more expenses each year than it receives in revenues; this has been done by the use of reserve funds of the City. These are now nearly exhausted. If this trend continues, Los Angeles could be forced to borrow to sustain present levels of expenditures. This point is illustrated by the current year (1975-76) budgeted expenditures of $882 million, which will exceed anticipated revenues by approximately $50 million.

Los Angeles also needs to address itself to fuller and more accurate disclosure to the public of its financial affairs including the issuance of better financial statements and accompanying information, which has been audited by independent certified public accountants. The present arrangement in the City calls for an annual audit limited to an examination of recorded cash receipts and disbursements, without an auditor's opinion on its assets and liabilities and results of operations, together with other important information relating to the City's financial position usually included in annual reports or prospectuses for borrowing purposes, such as annual cash flow, unfunded pension liabilities, etc.

Equally important, another ad hoc Los Angeles citizens committee appointed by the Mayor in 1975 recommended among other things that the financial organization of the City should be integrated to provide centralized direction under a chief financial officer and the system of financial checks and balances

improved. We support their recommendations and urge that the City Council which has been studying the report accept and implement the recommendations.

7. As to the recent recession and inflation, Los Angeles also has suffered financially with costs increasing more rapidly on a relative basis than revenues. In the absence of substantial economic recovery in this area, the City will have to address itself to a reduction in the level of expenditures and the consideration of revenue changes which will not have the adverse effect on the total community as has happened in New York.

Conclusions

Our report points up the fact that Los Angeles is facing tough financial problems - cash revenues which were less than cash expenses in recent years; taxes and other conditions that have contributed to the decisions of some major companies to move their headquarters out of the City in recent years, adversely affecting the job and tax base; city employee compensation and retirement benefits that appear to be better than comparable private sector earnings plus the need to make substantial cash payments for pension obligations underfunded in the past, etc. The report also includes some specific suggestions for attention by City officials which we would like to see reflected in the report of the full committee.

In light of information available to us and in the perspective of the finance crises in other large cities of the nation (particularly New York City), we have the following

observations to make on the fiscal position of the City of Los Angeles for the year beginning July 1, 1976:

Over a period of years, New York City's cash expenditures for operating the City and for capital improvements exceeded revenues received from the state and federal governments and from city taxes; the result was that it had to borrow funds on short and long term bases on an ever increasing scale. When the sources of borrowing finally dried up last year, New York City found itself at the brink of bankruptcy. The credit rating of the bonds and notes issued by New York City had, over 10 years, deteriorated from good to the point where new bonds were no longer salable.

In a nutshell, New York mortgaged the future. The cost of this policy is reflected in the interest expense on short term debt arising out of prior year operating cost deficits; in the fiscal year 1974-75, such interest amounted to about $500 million of an $11 billion operating expense budget.

The City of Los Angeles, in comparison, has managed its fiscal affairs very well--cash expenditures for operations have been financed by taxes imposed by the City and from revenues received from the federal and state governments; capital improvements have been financed by long term debt. As a result of its fiscal practices, the City's bonds are rated AAA.

However, in the past two years, as a result of inflation and recession, the City has had to virtually deplete reserve funds accumulated in 1973 and prior years when tax revenues exceeded budgeted expenditures.

Because of its practice of balancing annual budgets, Los Angeles has not had the cash liquidity problems of New York City. Nor is it like other major cities that are nearing the point where they also will no longer be able to borrow the cash needed to meet their obligations. <u>However, it appears to us that Los Angeles has reached a crucial time in its fiscal affairs</u>. We have come to this conclusion for the following reasons:

a. In this fiscal year which will end on June 30, 1976, about $40-$50 million in current year operating expenditures of $880 million will be financed out of the reserve fund.

b. Although the committee does not at this writing have a budget forecast for 1976-77, we have gained the impression, based on the trend of expenditures and revenues of the City in recent years and other information furnished to us in our review, that the City will be facing an expenditure level of over $1 billion; this could well exceed estimated cash revenues by an amount ranging from $50-$125 million. The actual forcast will, of course, depend (1) on actions that the Mayor and the Council take to eliminate or reduce expenditures and/or raise taxes or impose new taxes, and (2) on the continuation or reduction of present levels of federal and state aid in the form of revenue sharing and grants.

We hope the Mayor will be able to propose a budget for 1976-77 to the Council showing revenues in balance with planned

expenditures, and that there will be no need at this time for the City to consider short-term borrowings to meet its cash needs for fiscal 1976-77. We hope the City will be able to rebuild its reserve fund to a prudent level. Without the benefit of foreknowledge, however, we would like to see our full committee recommend that the Mayor and the City Council should reaffirm their policy of fiscal responsibility where the governmental needs of the City will continue to be served adequately and efficiently, but on the basis of living within its financial means without mortgaging the future. We fear that beginning down the road of budget deficits will lead to the cash illiquidity and possible insolvency problems of other cities.

In addition to this immediate major concern, we would like also to see recommendations in the full committee report embodying the following concepts:

1. The City should increase the attractiveness of the City to live in and work in, with due regard to environmental and other quality of-life considerations, the need to provide jobs for an increasing labor force, and the importance of an economic base which will provide the basic tax revenues to support the financial needs of the City. To accomplish this, the City should (a) develop policies which will increase its attractiveness as a site for locating business and industry in order to expand its economic base, and (b) work with representatives of the private

sector, federal, state and county government, and the school district to develop joint policies to increase access to employment for low income and minority residents.

2. The City should take a firm approach to arriving at reasonable compensation costs in total (staffing levels, wages and salaries and fringe benefits) which it can afford to pay without mortgaging the future.
3. The City should exercise extreme care in accepting any program which is funded in whole or in part by the state or federal government, with particular reference to the impact on the City's finances which might occur on termination or reduction of support for such programs.
4. The City should take strong action in urging the state and federal governments to help the City finance the costs of services mandated by such entities.
5. The City should improve its financial organization, practices and controls and the reporting of its fiscal affairs to the public.
6. The City should rebuild and maintain its reserve funds at a prudent level for possible losses from self insurance and other contingencies.

As we see it, Los Angeles could start down the road to the New York type crisis if these simple facts of living within our means are disregarded for expediency. The media,

as well as the citizenry of Los Angeles, should be involved in a process of sound decision-making and full disclosure to keep the City in good financial health while furnishing an adequate level of municipal services.

II

REPORT OF THE SUBCOMMITTEE ON THE ECONOMIC HEALTH OF LOS ANGELES

UNIVERSITY OF CALIFORNIA, LOS ANGELES

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OFFICE OF THE DEAN
GRADUATE SCHOOL OF MANAGEMENT
LOS ANGELES, CALIFORNIA 90024

March 30, 1976

TO: J. Howard Edgerton
Chairman, Mayor's Ad Hoc Committee on City Revenues

FROM: Harold M. Williams
Chairman, Subcommittee on the Economic Health of Los Angeles

I am pleased to transmit the report of the Subcommittee on the Economic Health of Los Angeles. Our Report presents and assesses trends in the population and the economy of the city, including retail sales, personal income, assessed property valuation, city revenues, employment, and business activity. This report also serves to provide perspective for the balance of the report dealing with the city government's revenue potential and expenditure requirements.

In brief, we are concerned with the economic health of the city, and we hope that this report will assist in drawing attention to the fact that, while the rate of economic and population growth of Los Angeles has slowed, the demand for and cost of services from local government continues its growth rate essentially unabated. Indeed, many of the problems of any central city have cost and demand dimensions that do not correlate with economic and population growth. We believe that efforts to solve the fundamental problems must commence immediately. The problems will not disappear by themselves nor by the simple solution of limiting government expenditures to balance the city's current revenues.

We appreciate having the opportunity to be of service to the city, and we appreciate your leadership of this important study.

Respectfully submitted,

Subcommittee on the
Economic Health of Los Angeles

Harold M. Williams, Chairman
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HMW:bs
Encl.

February 18, 1976

The Mayor's Ad Hoc Committee on City Finances

Report of the Subcommittee on the Economic Health of the City of Los Angeles

1. INTRODUCTION

The basic charge to the Subcommittee on the Economic Health of the City of Los Angeles was to study and assess the environment within which the government of the City of Los Angeles operates. The study conducted was diagnostic in nature, highlighting trends that have or might have a negative impact on the City and its governance. An independent in-depth economic study was not conducted; available data and projections were utilized in conducting the analysis and arriving at the observations and conclusions outlined in this chapter.

The previous chapter of this report deals with the New York City problem, identifies the major causes of the dilemma, and suggests possible similarities to the City of Los Angeles. In brief, New York reflects the problem of many of the major cities in the country - growing demands for services, rapidly increasing costs of providing services, public employees' salaries and benefits growing rapidly and without regard to productivity, exodus of business and affluence to the suburbs, decaying neighborhoods, shrinking tax base, growing welfare rolls,

increasing public assistance requirements and inadequate concern and leadership in both the public and private sectors. New York is not that unique a situation - other cities and regions share the problem and potentially face the same experience.

Subsequent chapters deal with the revenue and expenditure potentials of the City of Los Angeles and each contains detailed historical information and projected future possibilities and needs. In brief, serious concern is expressed, and a number of specific recommendations are presented.

Within the foregoing context, this chapter will describe the current economic health of the City, identify trends, and present conclusions and recommendation. As befits a report of this nature, primary attention is devoted to problems. A danger exists that the reader and the general public may be persuaded that the City is in desperate shape. Such a conclusion would be most unfortunate and unwarranted. Basically, the City at this point in time is in good economic condition. Los Angeles is the third largest city in the nation and the heart of the second largest standard metropolitan area, Los Angeles County. The area has enjoyed remarkable growth in this century - growth in population, in economic base, and in employment opportunities.

Only in recent months have economists, politicians and public commentators come to the realization that the slowing of growth and economic expansion in California as a whole represents a new steady state condition and there is little reason to expect that the State might soon return to the feverish pace that was characteristic of California over the past several decades. To be sure, the State will continue to expand, but at a much slower pace than in earlier years. In brief, California's boom days are over. The State has matured, become less susceptible to wide cyclical fluctuations, and the economy is basically sound.

But there are forces in motion which, if allowed to continue, will seriously impair the economic health of the City. Los Angeles, of course, is not alone in this regard. As stated elsewhere in this report and in an earlier report ". . . Los Angeles is experiencing the same economic and social life-cycle that older cities of the world have experienced. The process first involves a growth phase, saturation, then stabilization followed by decline. Los Angeles appears to have reached a plateau of stabilization." The urban problems of the sixties have matured and hardened during the seventies as the middle class exodus to suburbia has accelerated, to be followed in many instances by the business and industries which depend on them as employees and/or customers. This trend leaves the core cities in mounting difficulties and with diminishing

governmental capabilities. In a nutshell, the issue is slowed economic and population growth while the demand for the cost of services from government continues to grow unabated. The design of detailed remedies to solve these issues is beyond the scope of this report. Hopefully, the warning signals and the support for change will provide the City's leadership, public and private, with the necessary encouragement to begin to tackle the problem before Los Angeles reaches the crisis point.

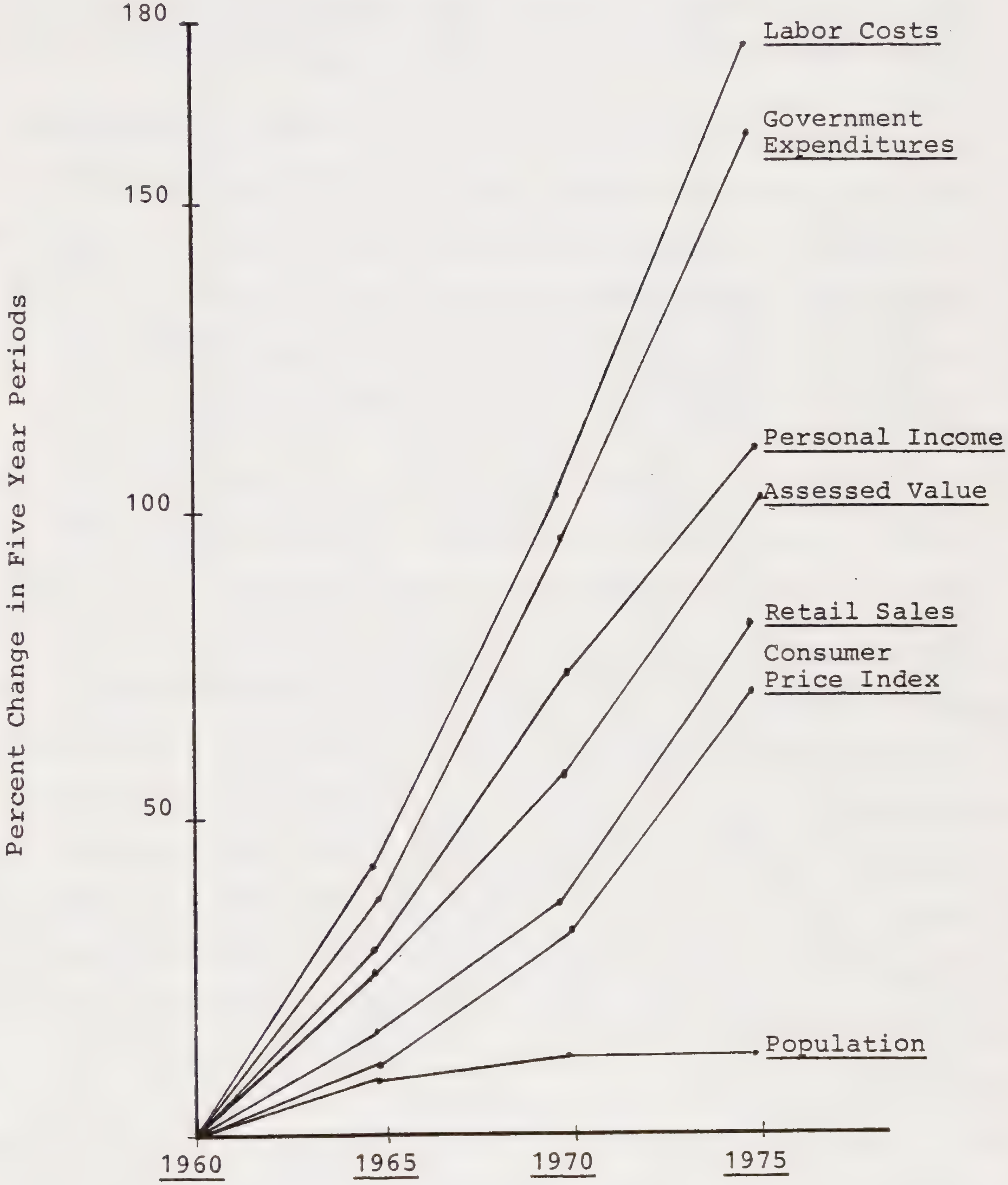
The exhibit at the end of this chapter presents base data on key indicators of the economic conditions in the community; these data were utilized in conducting the analysis and arriving at the conclusions in this chapter. The data were obtained from a variety of sources and, in most cases, were provided by City administrative personnel. The 1975 figures are subject to revision as additional information becomes available; they are 'best estimates' at this point in time.

2. POPULATION TRENDS

The following table on population and employment shows the changes that have occurred between 1970 and 1975 in population and employment at the State-level, Los Angeles 5-County Area (Los Angeles, Orange, Riverside, San Bernardino and Ventura counties) and Los Angeles County (in thousands):

Percent Change, City of Los Angeles

Population, Assessed Valuation, CPI, Retail Sales, Personal Income, Government Expenditures, Labor Costs



2/16/76

*1975 data are preliminary estimates.

	Total Population			Labor Force			Civilian Employment			Unemployment	
	1970	1975	%	1970	1975	%	1970	1975	%	1970	1975
Cal.	20,026	21,113	5	8,129	9,429	16	7,540	8,504	13	7.2%	9.8%
5-Co.	10,007	10,328	3	4,165	4,687	13	3,862	4,232	10	7.3%	9.7%
LA Co.	7,047	6,970	(1)	3,039	3,224	6	2,817	2,907	3	7.3%	9.8%

The numbers for 1975 are preliminary and subject to revision. In addition, the numbers shown are averages for each category for each year. The table reflects that the reduction in growth statewide is even more pronounced in Los Angeles County. It also points out that the labor force is growing more rapidly than civilian employment and that the 'job base' itself is nearly flat.

In the City of Los Angeles population appears to have stabilized at about 2.8 million persons. Between 1950 and 1970 the population nearly doubled; but between 1960 and 1970 the population increased by only 12 percent and remained essentially constant between 1970 and 1975, although a slight decrease in population actually occurred between 1970 and 1973 and the newly released metropolitan area figures of the U.S. Bureau of the Census estimates a 1.6 percent drop between 1970 and 1974. Most population experts do not foresee any substantial increase above the 2.8 million level in the City of Los Angeles for the balance of the decade and only modest increases at the State, 5-County and County levels.

The experience of practically every major city in the United States (particularly the older cities) is similar to that of

Los Angeles. The following table shows the population data for 1970 and 1973 for the top ten cities in the country. Only three of the ten experienced growth in that three year period, while seven declined. Los Angeles' decline (65,000 people, or 2.3 percent) is least severe of the top five cities, but is, nevertheless, sizeable.

Rank	City	1973	1970	Change	%
1	New York	7,647,000	7,896,000	-249,000	-3.1
2	Chicago	3,173,000	3,369,000	-196,000	-5.8
3	Los Angeles	2,747,000	2,812,000	- 65,000	-2.3
4	Philadelphia	1,862,000	1,950,000	- 88,000	-4.5
5	Detroit	1,387,000	1,514,000	-127,000	-8.4
6	Houston	1,320,000	1,234,000	+ 86,000	+7.0
7	Baltimore	878,000	906,000	- 28,000	-3.1
8	Dallas	816,000	844,000	- 28,000	-3.3
9	San Diego	759,000	697,000	+ 62,000	+8.9
10	San Antonio	756,000	708,000	+ 48,000	+6.8

Source: U.S. Census Bureau

In addition to the lack of significant growth in population in the City of Los Angeles, the composition of the population is changing. The ethnic composition of the City's population has undergone significant shifts in recent years. Between 1960 and 1970, the white population of the City declined in absolute numbers and in percentage of the total population, from 73 percent in 1960 to 60 percent in 1970; the black population increased from 13 percent in 1960 to 17 percent in 1970 and the Spanish-American population increased from 10 percent to 18 percent in the decade. Other ethnic groups increased from about 4 percent to 5 percent. The Los Angeles Board of Education now projects a

white minority student population by 1980. The age composition of the City's population also has changed in recent years with an increased proportion of working age adults and elderly. The Los Angeles Unified School District projects a continuation of the District's decline in enrollment for the balance of this decade. For the years 1970-71 to 1974-75 the average annual decline was 1.6 percent. The forecast is for a 2 percent decline per year through 1980. Such a trend is indicative of net out-migration of families. Population estimating in Los Angeles is complicated by the number of illegal aliens residing in the area and not included in the official population estimates.

The population dynamic of the central cities throughout the country is a familiar one. Those who migrate to the suburban areas tend to have higher family incomes, better job skills, lower age levels and higher educational attainments. The residents left behind in the central city are the disadvantaged - the elderly, the unskilled and the less educated. Such persons tend to have reduced earning power and require more government service, such as health, welfare, training, public transit, child care, police, and so forth. In such circumstances unemployment tends to be understated by the large number of economically disadvantaged who have long been out of the job market and the underemployed, both categories tending to be larger in the central city than elsewhere.

3. ECONOMIC TRENDS

Retail Sales

The trend of retail sales in an area is indicative of its vitality and, indirectly, of its tax revenue potential. Retail sales in the City of Los Angeles grew from $6.1 billion in 1970 to an estimated $8.9 billion in 1975, a 46 percent increase. During the same time period, retail sales grew by 64 percent State-wide and by 50 percent in Los Angeles County. Inflation in California over the past five years grew by 39 percent, as measured by the Consumer Price Index. Over a fifteen year period, 1960 to 1975, retail sales at the City level grew by 102 percent, while growing at 142 percent and 203 percent at the County and State levels.

Personal Income

Aggregate personal income in Los Angeles in the last five years grew 37 percent, as contrasted to a rise in the Consumer Price Index of 39 percent and no net increase in population. While Los Angeles City enjoys a relatively high standard of living (second highest in the country in terms of median family income and first in terms of the proportion of households with incomes over $15,000 per year), a sizeable percentage of the population requires income supplements, with 10% of families below the poverty level in 1970 and the County of Los Angeles Department of Public Social Services providing service to

800,000 to 900,000 citizens a year (of a County population of about 7 million) over the last several years. The changed composition of the population of the City in the past five years and the more difficult economic environment suggest that the problems are increasingly severe. While the largest metropolitan areas in the country still enjoy the highest levels of personal income, their rate of income growth has been below average. The two largest urban areas, New York City and Los Angeles, had annual income increases of 5.8 percent and 6.5 percent, respectively, between 1969 and 1973, while all other metropolitan areas enjoyed an average growth rate of 8.7 percent.

Assessed Property Valuation

The City's assessed property valuation has grown by 107 percent in the last fifteen years. The assessed value of the City was $4.3 billion in 1960, $7.2 billion in 1970 and $8.9 billion in 1975. In the same time period property taxes increased about 195 percent from $85 million to $251 million. In the last five years assessed valuation grew 24 percent while property tax revenues increased 47 percent. Despite increasing at a rate significantly greater than the growth in valuation, property taxes as a percentage of the City government's revenue declined from 39 percent in 1960 to about 32 percent in 1975. Other activity and commerce-related city taxes have offset the decline in property taxes as a percent of total revenues.

City Revenues

Total City revenues have grown from almost $218 million in 1960 to $778 million in 1975, an increase of 257 percent. In the last five years the increase was 58 percent against increases of 24 percent in assessed valuation, 37 percent in personal income, 46 percent in retail sales and 39 percent in the Consumer Price Index. The trend of the data makes it clear that City revenues (and, therefore, City expenditures) have been growing disproportionate to the growth of the economic base of the City. Since Los Angeles is already considered by a large number of informed people to be a high tax location, this steadily increasing tariff on property and economic activity within the City can be expected to have a negative impact on further economic growth.

Employment

Reliable data on the job base of Los Angeles City are difficult to find and subject to differing interpretation. In general terms, it can be said that job growth in the Los Angeles area since the early sixties has been less rapid than all but one major metropolitan area (New York) in the country. Losses have occurred in the manufacturing and construction sectors while growth has occurred in wholesaling, retailing and services sectors. The following table shows the percentage change in employment in Los Angeles County between 1962 and 1971 by major sector and in total:

Manufacturing	- 7.3%
Wholesaling	+16.4%
Retailing	+19.1%
Construction	-15.4%
Services	+35.8%
Total	+10.9%

Source: County Business Patterns Data

In 1973 in Los Angeles County, the manufacturing industry comprised 25% of the employment of the County, while trade (21%), service (24%) and government (13%) provided the bulk of the employment opportunities. What this says is that the Los Angeles area is emerging as a white collar and service industry area. Typically, these sectors require skilled employees. A key concern is that the employment base of the City is not likely to grow substantially and that future growth is likely to be in sectors that do not normally provide opportunities for the disadvantaged and less well educated segments of our population.

Industrial and Commercial Trends

It is difficult to develop comprehensive data on the ability of the City to attract and retain industry and commerce. However, enough pieces of information are available to raise concerns. The absence of more complete data may itself be indicative of less than adequate concern for the problem. The information available (including data from local utilities) suggests that Los Angeles City is experiencing a greater loss of business firms through relocation outside the City of Los Angeles than major cities in the country taken as a whole. During the course

of this study many examples were provided by service organizations, banks, real estate related firms and utilities, and by officers of corporations that have either moved out of Los Angeles City or have decided not to locate initially in Los Angeles. The reasons given were varied but the prevailing opinion seems to be that a more supportive and dependable governmental environment for business exists in other communities and in unincorporated territories within the basin than within the City itself. When the steadily increasing cost and burden of doing business in the City of Los Angeles appears to exceed the benefits and justify the expense and dislocation of moving out of the City, people, capital and businessmen will move - or they will not come in the first instance.

While the data are too incomplete to permit definitive conclusions, adequate information exists to indicate that many companies faced with plant and distribution center location decisions elect to establish such facilities outside the City of Los Angeles. In addition, there is also sufficient information to indicate that the City and State each has a reputation around the country as a difficult place in which to locate commerical and industrial activity. How widespread and how valid this opinion is cannot be determined without considerable more study. However, we are satisfied that it has a substantial basis in fact and is broadly held. Unless efforts are taken to correct the impression and the underlying causes, the effect is to either

erode or impede the further growth of the City's economic base. As a part of an early warning system, it would be worthwhile to track the aging of machinery, equipment and other capital stock within the City which are not being updated. These are often early indicators of decisions to not invest further in the City.

4. IMPACT OF OTHER JURISDICTIONS

Clearly, a more comprehensive study is needed of the total Los Angeles City environment before definitive conclusions can be presented. The proprietary departments (Harbor, Airport, DWP) and organizations such as the school district and the transit district are of considerable importance to the economic health of the community. But detailed study of the conditions of these organizations was beyond the scope and time frame of this report. For example, a significant growth in the budget deficit of the Los Angeles School District is projected - from a deficit of $41.4 million for 1975-76 to a deficit of $300.3 million by 1980 due to a projected 9.4 percent annual inflationary impact on General Purpose Requirements while General Purpose Revenue will only increase at about 3 percent annually. With these projections, the total tax required to balance the General Fund will increase from $4.99 per $100 assessed valuation in 1974-75 to $6.98 in 1979-80, a 40 percent increase. At the same time, a decline in school enrollment of 55,000 students (ADA) is projected by the District.

The quality and cost of service of the Los Angeles Department of Water and Power, as well as the continued security of its bond rating, are vital to the present and future economic health of the City. The availability of electricity and water at competitive rates is critical to industry and to individual consumers. The City government can derive no substantive comfort from the fact that it is not liable for the DWP revenue bonds; default or down-rating would seriously impact the overall health of the community. A recent national study by the Urban Institute pointed out that one of the characteristics of areas losing population is that they tend to have high energy costs compared to growing areas. Similarly, the absence of convenient, efficient and economical rapid transit is a serious deterrent to economic growth.

Many of the problems faced by the City of Los Angeles are imposed by governmental units beyond the control or ability of the government of Los Angeles to impact directly. For instance, the group of issues and concerns under the broad category of 'environment' has a major impact on business plans and attitudes, on growth in the City of Los Angeles, and on City expenditures. To illustrate, meeting the new environmental rules on sewage disposal will cost many millions of dollars for installation and are estimated to triple City operating costs (from $12 million to $36 million) per annum in a period of five years. Regulations of the Air Resources Board, of the Coastal Commission, of the

Environmental Protection Agency and other agencies at the State, local and Federal levels are having and will continue to have major impacts on the economic health of the City and its industrial base and, together with the total tax bill (State and local, income, sales, unemployment, franchise and property) will place California in a less competitive position vis-a-vis the rest of the nation and cause business and commerce to think twice before coming to California.

5. OBSERVATIONS

1. Los Angeles is not in crisis but rather at a point where decisive action must be taken to avert one.
2. The economy of the City is not unhealthy, but the time has arrived for a forthright assessment of the economic trends and of the revenue and expenditure patterns of the government of the City.
3. The City of Los Angeles is entering a prolonged period of slow to no economic growth - the population is not growing, the number of jobs is not growing significantly, the types of new jobs likely to be available will require skills that do not match the population trends of the typical central city.
4. The costs of governing and providing services to the citizens of Los Angeles are growing much more rapidly than either the growth of the population or any indicator of economic growth.

5. The City's tax base has failed to grow as rapidly as its revenue requirements due, in large part, to shifts in the location of economic activity and the continued suburbanization of middle and upper income groups. The City can exercise little direct influence over either the population trends or the tax base trends. Together they have produced a steady and increasing shift in City tax burdens, which has in turn affected the types of persons and business moving into or remaining in the boundaries of Los Angeles City.

6. It is unlikely that the trend of cost of government will decline of itself. Indeed, as the population of the City becomes more poor, less well educated and more requiring of public services the cost of government can be expected to accelerate further.

6. RECOMMENDATIONS

The Subcommittee submits the following recommendations. These recommendations, together with the recommendations in other sections of this report, are designed to prompt the City, both public and private sectors, to begin to tackle the emerging problems.

1. A thorough and critical review of the appropriateness of the government's salary and wage structures

(including unfunded pension costs) and other benefits should be initiated immediately as one means to reduce the cost of operation of the City's government. Labor costs represent approximately 72 percent of the government's annual expenditures and appear to be escalating more rapidly than non-public salary and benefit scales.

2. The total City budget and cost of services, not merely the proposed increment for the current year, should be thoroughly reviewed each year.

3. The current need for services being delivered should be reassessed, as well as their costs. The comparative cost of delivering the service through contract with other governmental jurisdictions or private services should be analyzed and, if attractive from both cost and dependability, given serious consideration.

4. Each City department should be required to establish appropriate measures of performance, effectiveness, and productivity and should be systematically evaluated against them.

5. An aggressive effort should be undertaken to build the economic activity of the City by stimulating and maintaining a healthy, competitive and viable business environment that will attract private investment and commercial activity.

While these recommendations and other recommendations in this report will aid in reducing the cost of government and in

building the revenue base of the City, the Subcommittee believes that solutions to the fundamental problems (beyond simply bringing expenditures into line to balance the budget or increasing taxes) must be found. No amount of responsible financial management will solve the basic problem of the central city, though sound management and tough budgeting practices can hold off the day when cash flow turns negative. The City cannot afford to solve the immediate problem of achieving a balanced budget at the expense of predictable long term negative consequences. If we reduce the services of the government so that those that are provided are inadequate in meeting the needs of the citizenry, we are encouraging those who can afford it to leave and the central city will become an ever increasingly undesirable place in which to reside and do business. Alternatively, if we raise taxes significantly to provide more services, the costs of living and engaging in commercial activity in the City of Los Angeles will also increase, with the eventual result that individuals and organizations who have a choice will conclude that they have more attractive opportunities outside the boundaries of the City. Over time the revenue base will decline and we will end up with the same negative results.

7. LONG TERM CONSIDERATIONS

Even given the savings that can be achieved with the various recommendations in this report, the City is ultimately faced with the need to assure a total environment that serves the needs

of all its citizens and that makes the City of Los Angeles not only a tolerable, but a desirable, place in which to reside and conduct commercial activity. To assure such an environment requires a reassessment of the relative priorities of the City which need to be concerned with services to the disadvantaged and with efforts designed to minimize the erosion in quality of life within the City of Los Angeles, but also with those services and conditions which will encourage and enhance the likelihood that individuals and businessmen will choose to come, remain and build their futures in the City of Los Angeles. These are not the conditions which exist today, and these are not the conditions which might be anticipated if we either continue on our present course or adopt as the total solution the cutting of expenditures to fit existing revenues.

The determination of the economic base of any central city and the process of job and population suburbanization is a deep seated phenomenon that is closely linked to rising living standards, technological change, and the effects of public policies that have encouraged and facilitated such shifts. What this means is that we are going to have to become accustomed to the idea that some cities are going to be less and less able to continue many of the activities that have long been taken for granted. Furthermore, to the extent that we consider some of these activities to be essential features of a civilized society, we are going to have to look for new ways to provide them. It

seems inevitable that the entire metropolitan area, if not the state and Federal governments, will become more heavily involved in the affairs of the central cities.

The ultimate solution will also require that the City recognize the growing reality that the appropriate jurisdiction for addressing many of its revenue and service requirements is increasingly one which embraces the entire metropolitan area. The residents of the suburban areas and the unincorporated territories must share equally in responsibility for the whole community and the consequences for the neglect of any of its parts. At the same time, City and County boundaries provide artificial barriers to dealing effectively with issues such as rapid transit, pollution, etc.

8. CONCLUSION

The transition from where we are to where we should be is not simple, immediate or painless. It will require aggressive, long-term, diligently implemented programs on the part of the Mayor and the City Council. It will require re-balancing of priorities and points of view within many departments and agencies of City government and a committed and involved citizenry. Further it will require that we look increasingly at what is good for the community and for the City of Los Angeles, which will not necessarily and in all instances be immediately and equally good for all 15 Council districts.

BASE DATA ON THE ECONOMY

	1960	1965	% Change 65/60	1970	% Change 70/65	1975*	% Change 75/70	% Change 75/60
Retail Sales ($ billion)								
1. City	4.4	5.1	16	6.1	20	8.9	46	102
2. County	9.8	12.4	26	15.8	27	23.7	50	142
3. State	23.4	31.7	35	43.2	36	70.9	64	203
Consumer Price Index	.870	.956	10	1.153	21	1.600	39	84
Government Revenue								
1. Total City Revenues ($ million)	217.8	309.3	42	491.8	59	778.5	58	257
2. Property Taxes ($ million)	85.2	113.4	33	171.1	51	251.6	47	195
3. Property Tax Rate (per 100)	1.96	2.09	7	2.35	12	2.82	20	44
4. Other Sources ($ million)	132.6	195.9	48	320.7	64	526.9	64	297
Government Expenditures								
1. Total ($ million)	209.9	287.7	37	457.9	59	761.4	66	263
2. Per Capita ($)	85	109	28	163	50	272	67	220

*1975 data are preliminary estimates and subject to revision.

February 16, 1976

BASE DATA ON THE ECONOMY

CITY OF LOS ANGELES

	1960	1965	% Change 65/60	1970	% Change 70/65	1975*	% Change 70/75	% Change 75/60
Total Population (million)								
1. City	2.5	2.7	8	2.8	4	2.8	--	12
2. County	6.1	6.8	11	7.0	3	6.9	(1)	13
3. State	15.9	18.5	16	20.0	8	21.1	6	33
Total Labor Force (millions) (Persons aged 14+)	1.1	n/a	--	1.2	--	1.3	8	18
Personal Income ($ billion)								
1. City	7.3	9.4	29	13.6	45	18.7	37	156
2. County	18.1	24.3	34	34.1	40	50.5	48	179
3. State	43.0	60.4	40	84.0	39	126.1	50	193
Assessed Value ($ billion)	4.3	5.4	26	7.2	28	8.9	14	84

*1975 data are preliminary estimates and subject to revision.

BASE DATA ON THE ECONOMY

	1960	1965	% Change 65/60	1970	% Change 70/65	1975*	% Change 75/70	% Change 75/60
City Government Employment								
1. Total	36,775	38,338	4	46,165	20	46,356	.4	26
2. Council-Controlled Departments	20,721	21,815	5	26,407	21	28,020	6	35
3. Other Departments	16,054	16,523	3	19,758	20	18,336	(7)	14
4. Employees per 1,000 Citizens (All Departments)	14.7	14.2	--	16.5	--	16.6	--	13
5. Employees per 1,000 Citizens (City Departments)	8.2	8.1	--	9.4	--	10.0	--	22
6. Salaries (City Departments) ($ million)	124.7	167.1	34	256	53	427.6	67	243
7. Labor Costs (Salaries, Pension and Retirements) ($ million)	138.8	200.0	44	318.3	59	547.8	72	295
8. Salaries as % of Expenditures	59	58	--	56	--	56	--	--
9. Labor Costs as % of Expenditures	66	69	--	69	--	72	--	--

*1975 data are preliminary estimates and subject to revision.

Sources: Board of Equalization; City Controller's Reports; City Budgets; Tax Payers Guide.

III

REPORT OF THE SUBCOMMITTEE ON CITY REVENUES

To: Mr. J. Howard Edgerton, Chairman
Ad Hoc Committee on City Finances

Following is the report of the Sub-Committee on City Revenues. The discussion of potential sources of revenues are not recommendations to increase taxes. They are presented only to evaluate various sources available in the event the natural growth in the current tax structure fails to generate the funds necessary to provide an adequate level of demonstrably needed services.

The Committee believes that the elected officials of the City of Los Angeles should constantly keep in mind both the principles of taxation and the criteria which define an acceptable revenue system as set forth in this report. If this is done, it is possible to eliminate, or at least reduce, the inequalities of both current and future tax structures.

Respectfully submitted,

Wm. R. Caldwell
Dr. James W. Cleary
Maurice J. Garrett
George R. Hearst
Dr. Gehard N. Rostvold
H. Russell Smith
Ernest J. Loebbecke, Chairman
James Moddlemog, Secretary

MAYOR'S AD HOC COMMITTEE ON CITY FINANCE

REPORT OF
SUBCOMMITTEE ON CITY REVENUES

February 1976

The charge to the Subcommittee on City Revenues was to: (1) review the City's current revenue sources; (2) identify problem areas associated therewith and recommend appropriate adjustments; (3) identify and make recommendations as to the most appropriate new sources of revenues for the City to consider should they become necessary in the future. The question of the need for such additional revenue sources was not addressed, since it is not within the purview of the Subcommittee's charge.

I. CURRENT REVENUE PROGRAM

Los Angeles is a charter city and, as such, has broad powers to levy and enforce taxes, to license, and regulate any lawful business and to impose other fees. The City's current sources of revenue can be broken down into two broad groups: General Purpose revenues and Special Purpose revenues. Table I reflects City revenues over a ten-year period.

General Purpose Revenues

These revenues consist of those which primarily flow into the City's General Fund and may be used for any valid purpose. Current sources are:

(1) Property Taxes - The City's Charter limits the property tax rate to $1.25 per $100 of assessed valuation for General Fund purposes, a portion of which is dedicated to library, recreation and parks, and capital improvement uses. However, the State has

TABLE I

ANNUAL REVENUES OF CITY OF LOS ANGELES

1965-66 Fiscal Year - 1974-75 Fiscal Year
(Thousands)

GENERAL PURPOSE REVENUES	1965-66	1966-67	1967-68	1968-69	1969-70	1970-71	1971-72	1972-73	1973-74	1974-75
Property Taxes	$ 69,063	$ 77,554	$ 79,465	$ 87,082	$ 88,820	$ 91,791	$ 95,763	$100,763	$ 97,816	$101,095
State Replacement of Property Tax Revenues	-	-	-	-	7,550	4,861	4,914	4,882	11,005	12,290
Sub-Total	$ 69,063	$ 77,554	$ 79,465	$ 87,082	$ 96,370	$ 96,652	$100,677	$105,645	$108,821	$113,385
Other City Taxes										
Sales Tax	$ 54,355	$ 57,107	$ 62,279	$ 89,878	$ 68,564	$ 65,927	$ 71,773	$ 79,985	$ 90,903	$ 96,088
Business Tax	21,331	26,904	27,365	29,292	30,470	48,106	50,331	54,370	58,481	61,541
Utility User's Tax	-	-	8,621	19,357	20,595	26,121	34,884	42,160	47,374	55,635
Transient Occupancy Tax	1,668	2,009	2,454	3,099	3,336	3,452	3,956	4,553	5,160	5,808
Cigarette Tax	6,496	9,323	5,794	-	-	-	-	-	-	-
Alcoholic Beverage Tax	-	-	-	4,248	6,295	-	-	-	-	-
Real Property Transfer Tax	-	788	717	959	882	884	1,164	1,498	1,438	1,204
Sub-Total	$ 83,850	$ 96,131	$107,230	$146,833	$130,142	$144,490	$162,108	$182,566	$203,356	$220,276
Shared Tax Revenues										
Motor Vehicle License Fees	$ -	$ -	$ -	$ -	$ -	$ 21,350	$ 21,099	$ 22,732	$ 26,689	$ 25,462
Cigarette Tax	-	-	7,515	11,562	11,504	11,828	11,920	12,399	12,608	13,253
State Liquor License Fees	1,810	1,676	1,822	1,825	1,576	2,215	1,858	1,818	726	2,554
State Transportation Tax	-	-	-	-	-	-	229	243	269	288
Sub-Total	$ 1,810	$ 1,676	$ 9,337	$ 13,387	$ 13,080	$ 35,393	$ 35,106	$ 37,192	$ 40,292	$ 41,557
Licenses, Permits, Fines & Fees	$ 24,993	$ 23,684	$ 30,256	$ 31,578	$ 40,876	$ 40,388	$ 47,493	$ 46,438	$ 53,031	$ 48,461
Grants	$ -	$ -	$ -	$ -	$ -	$ 3,544	$ 6,058	$ 7,999	$ 7,963	$ 8,103
Transfers From Proprietary Departments										
Department of Water & Power	$ 9,619	$ 10,306	$ 10,583	$ 11,501	$ 12,130	$ 13,689	$ 15,207	$ 17,217	$ 20,442	$ 23,024
Department of Airports	250	500	750	750	1,000	1,000	3,750	3,750	3,691	5,435
Harbor Department	-	-	-	-	-	500	-	500	-	750
Sub-Total	$ 9,869	$ 10,806	$ 11,333	$ 12,251	$ 13,130	$ 15,189	$ 18,957	$ 21,467	$ 24,133	$ 29,209
Other Income										
Interest	$ 7,356	$ 8,134	$ 6,352	$ 10,484	$ 16,100	$ 15,645	$ 10,686	$ 11,979	$ 19,798	$ 30,744
Sewer Connection Charges	-	-	-	-	-	5,222	6,892	7,569	5,919	4,518
Franchise Income	1,816	2,763	1,949	2,050	2,109	2,276	2,364	2,457	2,536	2,632
Rentals & Parking Fees	269	256	242	212	286	-	-	212	500	186
Miscellaneous	979	146	-	-	-	6,970	-	-	-	551
Sub-Total	$ 10,420	$ 11,299	$ 8,543	$ 12,746	$ 18,495	$ 30,113	$ 19,942	$ 22,217	$ 28,753	$ 38,631
Transfers From Reserve Fund	$ 6,798	$ 3,996	$ 6,000	$ -	$ 27,493	$ 10,000	$ 17,387	$ -	$ -	$ 21,687
GRAND TOTAL GENERAL PURPOSE REVENUES	$206,803	$225,146	$252,164	$292,315	$328,082	$375,769	$407,728	$423,524	$466,349	$521,309

TABLE I CONTINUED

ANNUAL REVENUES OF CITY OF LOS ANGELES

1965-66 Fiscal Year - 1974-75 Fiscal Year
(Thousands)

SPECIAL PURPOSE REVENUES	1965-66	1966-67	1967-68	1968-69	1969-70	1970-71	1971-72	1972-73	1973-74	1974-75
Special Funds										
Property Taxes for City Retirement & Pension Plans, including State Replacement	$ 37,000	$ 39,962	$ 45,346	$ 60,233	$ 61,356	$ 74,530	$ 80,958	$ 93,822	$105,108	$117,862
Airport & Harbor Department Payments to City Pension Fund	186	253	385	817	967	1,211	1,323	1,366	1,518	2,484
Traffic Safety - Fines & Forfeitures	11,036	9,008	8,463	9,484	11,839	12,467	13,980	14,472	14,359	13,977
Special Parking Revenue Fund	1,003	1,042	1,095	1,131	1,077	1,121	1,123	1,306	1,908	1,884
Street Lighting Assessments	2,092	-	320	400	450	1,000	1,000	1,000	1,000	1,000
For-Hire Trucking Revenues	323	282	316	284	307	139	357	146	159	149
Sewer Construction & Maintenance Fund	-	-	-	-	-	-	-	2,664	8,364	12,931
Park & Recreation Sites Facilities Fund	-	-	-	-	-	-	-	2,009	1,615	654
Auditorium Revenue Fund	-	-	-	-	-	-	-	-	1,505	1,597
Off-Highway Motor Vehicle Fund	-	-	-	-	-	-	-	-	-	39
Available Balances	2,798	1,287	113	5	1,274	3,123	467	3,506	1,271	4,289
Sub-Total	$ 54,438	$ 51,835	$ 56,037	$ 72,356	$ 77,270	$ 93,591	$ 99,208	$120,291	$136,874	$156,756
Subvention & Grant Funds										
State Gasoline Taxes	20,929	18,550	28,578	22,910	24,266	24,578	26,376	25,944	24,939	24,806
Interest Allocation on Special Gas Tax Improvement Fund	-	1,166	1,750	2,600	2,700	2,500	1,650	1,400	2,150	2,000
County Allocation-Gas Tax & Motor Vehicle Fees	1,917	3,157	3,283	3,384	3,538	3,700	3,878	3,896	4,326	4,165
Grants, including Interest on Trust Funds	-	-	-	-	-	-	-	15,623	38,893	40,170
State Motor Vehicle Fees	17,427	17,480	18,491	19,594	20,322	-	-	-	-	-
Cigarette Tax	-	-	-	11,562	11,504	-	-	-	-	-
State Highway Fund-Service Agreements	881	771	792	636	775	694	598	650	503	469
Other	1,721	1,713	1,520	650	400	400	1,100	1,948	1,685	1,385
Available Balances	576	846	90	2,973	1,915	-	100	1,329	24,710	3,553
Sub-Total	$ 43,451	$ 43,683	$ 54,504	$ 64,310	$ 65,420	$ 31,872	$ 33,702	$ 50,785	$ 97,206	$ 76,547
GRAND TOTAL SPECIAL PURPOSE REVENUES	$ 97,889	$ 95,518	$110,541	$136,666	$142,690	$125,463	$132,910	$171,075	$234,080	$233,303

TABLE I CONTINUED

ANNUAL REVENUES OF CITY OF LOS ANGELES

1965-66 Fiscal Year - 1974-75 Fiscal Year
(Thousands)

	1965-66	1966-67	1967-68	1968-69	1969-70	1970-71	1971-72	1972-73	1973-74	1974-75
BOND REDEMPTION AND INTEREST REVENUES										
Property Taxes, including State Replacement	$ 16,144	$ 15,735	$ 16,603	$ 17,967	$ 16,752	$ 16,515	$ 18,713	$ 22,280	$ 20,418	$ 19,744
Airport Revenue Fund	3,957	3,520	3,206	3,151	3,098	3,165	3,397	3,669	3,700	2,717
Power Revenue Fund	478	343	171	99	97	95	93	90	88	86
Water Revenue Fund	1,566	1,505	1,283	1,220	1,136	1,096	783	691	583	362
Other	463	476	279	123	-	-	-	-	-	-
GRAND TOTAL BOND REDEMPTION AND INTEREST REVENUES	$ 22,637	$ 21,580	$ 21,543	$ 22,560	$ 21,083	$ 20,870	$ 22,987	$ 26,730	$ 24,790	$ 23,911
TOTAL REVENUES ALL SOURCES	$327,444	$342,098	$384,249	$451,542	$491,856	$522,092	$563,575	$621,330	$725,220	$778,523

Note: Small variances in totals are due to rounding of all figures.

permitted the City to increase its maximum allowable rate to an estimated $1.41 per $100 of assessed valuation.

(2) Other City Taxes -

(a) A Sales Tax of one percent collected by the State and remitted to the City after deduction of administrative costs.

(b) A Business Tax imposed on businesses and occupations. The tax is largely based on gross receipts, with rates ranging from $1 per $1,000 for wholesalers up to $5 per $1,000 for professional and occupational groups. There are over fifty separate rate schedules.

(c) A Utility User's Tax levied on all users of gas electricity and telephone services in the City. The rate on all gas and telephone users and on non-commercial users of electricity is five percent; commercial users of electricity pay ten percent.

(d) A Transient Occupancy Tax levied at the rate of six percent on all rental charges for hotel and motel rooms.

(e) A Real Property Transfer Tax imposed at the rate of $0.55 per $1,000 of sale value, with the County collecting the tax and remitting funds to the City.

(3) Shared Tax Revenues - A significant portion of the City's revenues are received from the State - i.e., the State shares these

revenues with local governments on the basis of various formulas. Included in this category are:

(a) Motor Vehicle License Fees which are levied by the State at the rate of two percent of the market value of vehicles and apportioned equally to counties and cities on the basis of population.

(b) Cigarette Taxes levied by the State at the rate of 10¢ per package, with 3¢ of the tax allocated monthly between cities and counties on the basis of taxable sales and population.

(c) Liquor License Fees which are imposed by the State annually on all those engaged in on- or off-premises sale of alcoholic beverages. About ninety percent is returned to cities where fees were collected.

(d) Transportation Taxes which are levied by the State at the rate of 1/10 of one percent on gross operating revenues of inter-city highway carriers, with about twenty-three percent of receipts allocated to cities on basis of population.

(4) Licenses, Permits, Fees and Fines - The City engages in a number of regulatory activities and charges license and permit fees in order to cover the cost of these activities. A few examples are: building and safety permits; police permits; fire permits; engineering fees; and dog licenses. Municipal court fines also

generate revenue for the City, representing largely fines for traffic violations other than those under the State Vehicle Code.

(5) Grants - State and Federal grants for a variety of City programs are credited to the General Fund when their receipt represents reimbursement for funds already spent through previous budget appropriations. A few examples of the major programs for which reimbursement was received during the last fiscal year were: Model Cities Program; Manpower Program; Community Analysis Program; and Emergency Employment Act of 1971. It should be noted that not all grant receipts and expenditures are included in the City's budget. As a result, both revenues and expenditures are understated by the City's budget.

(6) Transfers From Proprietary Departments - The Water and Power, Airport, and Harbor Departments all make annual payments which are credited to the City's General Fund. Of these, the payment by the Water and Power Department is by far the most important. Currently, the City and this Department are operating under an agreement whereby it pays each year an amount equal to five percent of its operating revenues for the preceding fiscal year.

(7) Other Income - The City has various other General Purpose revenue sources. Interest from investment of temporarily idle funds is one. Sewer connection charges is another. Income from franchises the City grants to various businesses for the privilege of using public properties within the City is still another. And finally, certain City-owned enterprises generate revenues in the form of rentals and parking fees.

(8) Transfers From Reserve Fund - The City's Reserve Fund essentially is a reservoir into which flow previously appropriated funds which were not expended or encumbered. A Reserve Fund of considerable magnitude is generally believed to be necessary for funding unforeseen contingencies or other interim non-budgeted expenditures and, since the City is self-insured, for providing for obligations it may incur as a result of successful legal claims. In seven of the past ten years, the City has transferred funds from the Reserve Fund to fund budgetary appropriations which were in excess of revenues.

Special Purpose Revenues

These revenues consist of those which are earmarked for special purposes. The largest portion of these revenues (about forty-nine percent) is represented by property taxes which are dedicated to the City's retirement and pension plans and to bond redemption and interest payments on City debt obligations. Other sources which provide significant support for specialized, ongoing budget expenditures are:

(1) State Gasoline Taxes which are levied and collected by the State at the rate of 7¢ per gallon. A total of 1.765¢ of this tax is allocated by the State to cities and counties for street purposes.

(2) State Vehicle Code Fines, consisting of fines and forfeitures collected from any person charged with a misdemeanor under the State Vehicle Code.

(3) Sewer service charges which are levied on commercial,

industrial and governmental users of its sewage systems.

(4) Federal general revenue sharing grants which were provided for in The State and Local Fiscal Assistance Act of 1972. While this Act does define priority areas for use of these revenue-sharing funds, the defined areas are very broad so that, in fact, these funds come very near to being the equivalent of a General Purpose revenue source for the City.

Table I contains a history of the City's revenues for the ten-year period ending with its 1974-1975 fiscal year.

Revenue Growth Trends

Table II shows the annual percentage changes and the compound growth rates of the current General Purpose revenue sources and the major Special Purpose revenue sources for the past five fiscal years. All tax revenues were adjusted to exclude all revenues estimated to have been generated by tax rate increases after the 1969-1970 fiscal year. Hence, the estimated growth of these revenues reflects their natural growth. The table also shows the growth rates of the revenue streams after adjustment for inflation, using the GNP Implicit Price Deflators for the adjustment. The following observations seem pertinent.

(1) The growth rate of the City's total General Purpose revenues over the past five years was about six percent. After adjustment for inflation, there was essentially no real growth in these revenues.

(2) With the exception of sewer service charges, none of

TABLE II

CITY REVENUE GROWTH TRENDS

1969-70 Fiscal Year - 1974-75 Fiscal Year

GENERAL PURPOSE REVENUES	1969-70 Base Year Revenues ($000)	Approximate Annual % Changes 1970-71 %	1971-72 %	1972-73 %	1973-74 %	1974-75 %	Approximate 5-Year Compound Growth Rates: Unadjusted For Inflation %	Adjusted For Inflation %
Property Taxes, including State Replacement	$ 96,370	4	3	5	4	5	4	(2)
Other City Taxes								
Sales Tax	71,600 Est.*	(3)	9	6	13	6	6	(0.4)
Business Tax	30,470	5	5	8	8	5	6	(0.2)
Utility User's Tax	20,595	3	1	19	12	17	10	3
Transient Occupancy Tax	3,336	(2)	(3)	15	14	12	7	0.4
Real Property Transfer Tax	882	0	32	29	(4)	(16)	6	0
Sub-Total	$126,883 Est.	0%	6%	9%	12%	8%	7%	0.3%
Shared Tax Revenues								
Motor Vehicle License Fees	$ 20,321	5	(1)	8	17	(5)	5	(2)
Cigarette Tax	11,504	3	1	4	2	5	3	(3)
State Liquor License Fees	1,576	40	(16)	(2)	(60)	250	10	4
State Transportation Tax	-	-	-	6	7	7	-	-
Sub-Total	$ 33,401	6%	0%	1%	2%	3%	4.5%	(2)%
Licenses,Permits,Fees & Fines	$ 40,876	(1)%	18%	(2)%	15%	(8)%	3.5%	(3)%
Transfers From Proprietary Departments	$ 13,130	16%	25%	13%	12%	21%	17%	10%
Other	18,495	-	(34)	11	29	34	16	9
GRAND TOTAL GENERAL PURPOSE REVENUES (Ex. Grants)	$329,155	5%	4%	6%	10%	7%	6%	0%
MAJOR SPECIAL PURPOSE REVENUES (Ex. Grants)	$ 42,343	8%	6%	5%	12%	7%	6.5%	0%
% Change in GNP Implicit Price Deflator		5.2%	2.8%	5.0%	9.6%	9.9%		

* Actual Sales Tax revenues were $68.6 million in the 1969-70 fiscal year. Gasoline sales became subject to the Sales Tax as of July 1, 1972. In order to put the tax base on a comparable basis for all years, revenues from the Sales Tax on gasoline were estimated for the three fiscal years 1969-70 through 1971-72 and added to the actual revenues in those years.

the major Special Purpose revenues showed any real growth during the past five years.

(3) Many of the City's major General Purpose revenues grew at rates considerably below the rate of inflation. Notable examples were property taxes, shared tax revenues and licenses, permits, fees and fines.

(4) The Utility User's Tax and the annual payments to the City by the Department of Water and Power grew at relatively high rates because of the increases in utility charges in recent years which were due in part to the precipitous increase in fuel prices.

Problems in Current Revenue Structure

While the City's tax powers under its Charter are broad, in practice they are limited in many areas. Various statutory restrictions limit its ability to raise additional revenue from existing sources. Some of the important ones are:

(1) Property Tax - The City's Charter sets a maximum allowable rate of $1.25 per $100 assessed valuation on property taxes levied for general governmental purposes. A constitutional amendment approved by the voters in 1968 gave the State the sole power to alter this maximum allowable rate. Subsequent State legislation permitted the City to adjust its Charter-imposed maximum rate upward to reflect changes in population, assessed values and the Consumer Price Index. Nevertheless, the existence of the legal maximum does restrict the City's options for increasing property taxes.

(2) <u>Sales Tax</u> - All California cities, including Los Angeles, presently levy their local sales tax under the provisions of the Bradley-Burns Uniform Local Sales and Use Tax law which requires that all cities and counties impose a one percent sales tax on a uniform basis throughout the State. Therefore, any change in the tax rate or tax base is dependent on statutory changes at the State level.

(3) <u>Shared Revenues</u> - Many of the revenues received in the form of subventions from the State are restricted to specified uses rather than being available for general purposes. Furthermore, it is clear that the City cannot unilaterally take any action to increase revenues from these sources. Any such changes would require statutory action at the State level.

In addition to the statutory restrictions mentioned above, the City is hampered in its ability to adopt new revenue sources by the fact that the State has <u>preempted</u> some of the areas of taxation with the highest potential for raising substantial amounts of new revenues. The major areas in this regard are:

(1) <u>Income Tax</u> - Section 17041.5 of the State Revenue and Taxation Code expressly prohibits all cities from imposing a tax on income. While there has never been a definitive court ruling on this statute, the State Attorney General has ruled that the State has preempted this field of taxation.

(2) <u>Alcoholic Beverage Taxes</u> - The Courts have ruled that the State has preempted the entire field of taxation on the sale of alcoholic beverages.

(3) Motor Vehicle Use Taxes - Based on the substance of the court rulings on alcoholic beverage taxes, some legal authorities believe that it is likely the Courts would also rule that the State has preempted the field of taxation on automobiles.

Finally, in addition to the statutory limitations and State preemption of potential revenue sources, there are obviously economic limitations in this regard also. Because of the relatively slow natural growth of the City's revenues and its inability to tap potentially large revenue sources due to statutory limitations or State preemption, there is constant pressure to increase tax rates on City-imposed taxes. At some point, however, this becomes self-defeating, because it tends to drive people and businesses to surrounding communities with lower tax rates, thus inhibiting further what already appears to be a relatively static economic and population base.

II. REVENUE CRITERIA

The search for new revenue sources for the City of Los Angeles should first take cognizance of both the "benefit" and the "ability" principles of taxation. These provide the general public policy framework for the revenue system. The search for new revenue sources should also weigh and consider the criteria which define an acceptable revenue system in a democratic society.

For the purposes at hand, a principle is defined as a comprehensive doctrine of taxation. Principles represent a broad and general framework within which to effect changes in the existing

revenue system. Tax selection criteria, on the other hand, are defined as the set of standards which should be followed in determining what the revenue system should be.

The Benefit Principle of Taxation

The benefit principle of taxation is based upon the proposition that those who benefit directly from a governmental expenditure program should bear the costs thereof. In California, motor vehicle in lieu taxes and motor fuel taxes are earmarked for spending on highways, bridges, freeways, and vehicle-related transportation system improvements. This represents a direct application of the benefit principle.

When should the benefit principle be applied? Five considerations generally govern the application of this principle: First, it should be possible to trace the benefits of an expenditure program directly to the taxpaying unit; second, the monetary value of the public good or service should be measurable, or convertible into a price; third, the relative and absolute per unit cost of the public service should be within the economic means of the majority of the citizenry; fourth, the taxpaying units (and users) should have the economic ability to pay for the service; fifth, the criteria of administrative simplicity and feasibility should be met.

The third and fourth standards for the application of the benefit principle are closely linked to the ability principle of taxation. The third proposition suggests that the benefit principle should not be applied if the fee for the public service is so high that it works a hardship on the taxpaying unit. The fourth supports the position that the concept of taxation or revenue production

should not be applied in instances where tax paying units without economic means might be penalized by the burden of the fee structure.

The Ability-To-Pay Principle of Taxation

This principle of government finance is built upon the tenet that those individuals and businesses which have the economic means to do so should bear the monetary costs of public expenditure programs. Three common measures of "ability-to-pay" are: Income, wealth, and spending.

One school of thought offers the proposition that the ability-to-pay principle is best suited to finance those public expenditure programs where the benefits are broadly diffused throughout the society. Thus, insofar as public education is beneficial to most, if not all, social and economic sectors, it appears logical to finance education on the ability-to-pay principle.

Ability-to-pay generally connotes some degree of progressivity in the tax-rate structure. This is to say that the tax rate increases as the tax base increases. Income taxes are commonly levied with a progressive rate structure.

If we link both the revenue and the expenditure functions of government together under the ability-to-pay principle of taxation, two basic fiscal guidelines appear. The first is the concept of progressivity; the second suggests the utilization of a progressive tax rate structure to finance those governmental programs, e.g., education, police and fire protection, where the benefits are broadly diffused throughout the society. Thus, on the revenue side, ability suggests some degree of progressivity; on the expenditure side, broad diffusion of benefits becomes a condition for fiscal optimization.

Revenue Selection Criteria

The benefit and ability principles define the general social policy framework for a system of taxation. There are also certain specific criteria or standards that an "ideal" revenue system should meet. These criteria can best be set out in a series of maxims:

Maxim 1 - The tax system should be compatible with such social value criteria as equity, convenience of taxpayer compliance, simplicity, and predictability of incidence.

Maxim 2 - The revenue system should be fiscally adequate, broadly based, stable in its yield, and balanced in its final incidence. These are the so-called "fiscal" criteria.

Maxim 3 - The revenue system should be administratively simple, economical to administer; the tax base and the tax-rate structure should be clearly defined.

Maxim 4 - The tax system should be devised to minimize adverse impacts on economic efficiency,productivity, and resource allocations.

Maxim 5 - The revenue system should produce minimum negative impact upon the levels of employment, income, output (real GNP),saving, investment and consumer spending.

Maxim 6 - The revenue system should reflect and sustain a high degreee of taxpayer awareness concerning the real income sacrifices inherent in the payment of taxes to government.

Maxim 7 - Changes in the revenue system should be responsive to taxpayer preferences.

Maxim 8 - Changes in the local revenue system should be conditioned by the manner in which existing federal, state, and local tax burdens are distributed within the business-industrial and household sectors of the private economy.

Maxim 9 - The fiscal capabilities of the revenue system should be adaptable to cyclical and inflationary economic trends.

Maxim 10 - The tax system should have minimal adverse effects on financial markets.

III. POTENTIAL NEW REVENUE SOURCES

The Subcommittee identified and investigated a broad list of possible new revenue sources the City might utilize should it become necessary to do so. It categorized these possible new revenue sources as between those that could be implemented in the short-term and those that presumably could only be implemented over the long-term. Short-term sources were defined as those which could be implemented relativel quickly by City action and long-term sources as those which would require considerable time to implement because either statutory or constitutional changes would be required or their controversial nature would probably preclude quick adoption.

If the City must seek new revenue sources, the Subcommittee believes the following deserve priority consideration because they

conform most closely to the two principles of taxation and to the specific tax selection criteria discussed in the preceding section.

Short-Term Sources

The application of user's fees should be given priority consideration as short-term revenue sources because of their conformity to the important benefit principle of taxation. The following user's fees, which could be enacted by ordinance, are recommended.

(1) An admissions tax on sports and other entertainment events - Such a tax is currently levied in neighboring cities (e.g., Inglewood and Arcadia) with no evidence that it has had a detrimental influence on attendance. Revenues from such a tax could be substantial, depending on the extent of its application.

(2) A sewer service charge - Such a tax is currently levied on commercial, industrial and governmental users of the City's sewage system in order to comply with State and Federal grant requirements. It could be extended to residential users with collections made by the Department of Water and Power through its regular billing system. Revenue yield would approximate $1,100,000 per one-cent charge on every 100 cubic feet of water.

(3) A refuse collection fee - A monthly charge of $1.50 per single-family residence and two-to-four family dwelling, plus a 75¢ per unit fee on multiple dwellings of five or more units, could generate sufficient revenues to recover the approximately $29 million the City now spends annually on refuse collection.

(4) Parking Fees at City-owned facilities - A fee of 50¢

per vehicle for use of parking spaces at facilities such as the Los Angeles Zoo, the Griffith Observatory, the Greek Theatre and the Ports O'Call recreation and shopping complex could generate significant revenues for the City.

(5) Recreation fees - Imposition of fees for use of public tennis courts and increased fees for use of public golf courses, swimming pools, municipal camps and sports permits could help recover the substantial costs of providing these facilities.

(6) A library card fee - The City Library could charge a fee for library cards renewable periodically, with students and senior citizens exempted.

(7) Increased animal regulation fees - An across-the-board increase in these fees along the following lines could generate about $1 million in additional revenues. An increase in dog license fees to $10 for unaltered dogs and $5 for altered dogs; an increase in animal shelter fees from $6 to $10; and an increase in the kennel boarding rate from $1 to $5 per day.

(8) A commercial parking lot tax - A tax on the occupancy of parking lot spaces could be levied on the motorist with collection by the parking lot operator. The revenue yield would approximate $1.5 million per one percent of tax rate.

The Subcommittee also recommends that the City take steps to apply the Business Tax uniformly on a gross receipts basis. Some enterprises currently are taxed at a flat rate, creating an

inconsistency in the application of the tax.

Long-Term Sources

The Subcommittee considered a broad list of possible long-term revenue sources. Several of these were excluded because of conflict with the taxation principles and tax selection criteria set forth earlier. Those excluded on this basis were: (1) A stock and bond transfer tax; (2) An advertising media use tax; (3) An increase in the tax on oil production; (4) A payroll expense tax; and (5) A business tax on airlines.

Set forth below are the long-term revenue sources the Subcommittee believes should be given priority consideration by the City. They have been divided into two categories: (1) Sources requiring no legislative or legal changes; and (2) Sources requiring legislative or legal changes.

(1) Sources requiring no legislative or legal changes:

Occupation Tax - A tax based upon a percentage of salaries, wages or commissions earned by every person, resident or non-resident, employed in the City. While it has the disadvantages of being cyclical and perhaps creating another incentive for businesses to locate outside the City, the Subcommittee believes the following advantages clearly outweigh these disadvantages.

(a) The tax would produce substantial revenues (estimated at about $12 million per one-tenth of one percent of tax rate).

(b) It could be collected on the withholding system.

(c) Its administrative costs would be reasonable in

relation to revenue generated.

(d) It would spread the costs of government as between residents and commuters.

(e) It has worked well in Birmingham, Louisville, Denver, Kansas City and Philadelphia.

(2) Sources requiring legislative or legal changes:

Income Tax - Two possible forms of utilizing an income tax were considered: (a) A City Income Tax; and (b) A State-Local Shared Income Tax. The Subcommittee believes the latter form represents the best approach. Set forth below is a brief description of this tax and the findings with regard to it.

State-Local Shared Income Tax - A fiscal arrangement by which the current state income tax rate would be increased by a given percentage and by which the State, upon collection, would deliver to all units of local government (excepting special districts) those revenues deriving from the increased percentage.

Advantages

(a) While enabling legislation (i.e., repeal of Section 17041.5 of the State Revenue and Taxation Code)would be required, and while the political climate in Sacramento may not be conducive to much support for such legislative action, there are legislative precedents for this concept of shared state-local tax systems which would make this proposal more attractive than the City-imposed income tax system.

(b) This shared income tax system involves the creation of no new tax agencies.

(c) It avoids the cumbersome problem of direct administration at the local level.

(d) No new tax procedural responsibilities are placed upon individuals and businesses, as the proposal is built upon tax procedures and programs already in effect at the state level.

(e) The local revenue system would be tied closely to the growing level of income which represents the best measure of economic growth and progress in the local and state economies.

(f) This system would correlate the distribution of tax burdens more closely with the ability-to-pay principle of taxation.

(g) Depending upon the percentage earmarked for local units of government, the yield could be as great as, or even greater than, that from City-imposed income tax.

(h) Like the City-imposed income tax, the substantial revenue derived from a State-Local Shared Income Tax could permit for a considerable time the maintenance, or even reduction, of the current level of property taxes and, accordingly, alleviate the tax burden on property owners.

(i) Like the City-imposed income tax, the State-Local

Shared Income Tax reaches the commuter to help defray services he/she enjoys when present in the City for work, personal business, social and other related purposes.

(j) Like the City-imposed income tax, the State-Local Shared Income Tax would be deductible from the Federal Income Tax.

<u>Disadvantages</u>

(a) The State-Local Shared Income Tax may be considered by many as too revolutionary or too radical, and hence a broad base of support would be difficult to generate.

(b) There is a risk of an adverse impact on the State and local economies should the general economy experience instability and a business downturn.

(c) There is a risk that the increase in the income tax, though shared, would encourage a segment of the population to migrate to other states, thus reducing both the State's and local units' taxable capacity.

(d) Because the State-Local Shared Income Tax would be sponsored and administered by the State, there is a risk of greater State control of the revenues returned to the local governmental units, and a consequential reduction of local autonomy.

<u>Conclusion</u>

Because the State-Local Shared Income Tax contains all of

the advantages of the City-imposed income tax, because it eliminates the costly bureaucratic and administrative factors associated with the City-imposed income tax, because the risks are minimal, and because there are legislative precedents for the state-local "shared tax" concept which may offset contentions that the "shared" approach is too revolutionary, the State-Local Shared Income Tax should be recognized as a viable proposal for creating a major source of new tax revenues for the City.

Increase in automobile license fees - The Subcommittee estimates that an increase in this fee by the State from the current two percent to three percent of market value would generate approximately $13 million in additional revenues for the City on an annual basis, with no additional costs involved.

Alcoholic beverage tax - An excise tax on the purchase price of alcoholic beverages sold by retailers for consumption on the premises. A five percent tax would generate an estimated $8.5 million of revenue for the City. Previous City experience with such a tax indicated administrative costs would be reasonable, approximating $100,000 annually.

Increase in cigarette tax - Assuming continuation of the current State apportionment formula, every 1¢ per package increase in the tax above the current 10¢ per package rate would generate about $1.3 million in additional revenue for the City. There has been no increase in this tax since 1967, and many states have much higher

tax rates. Little or no additional administrative costs would be involved.

<u>City tax on Banks and other Financial Institutions</u> - A constitutional amendment would be necessary in order for the City to levy any taxes on these institutions. The Subcommittee believes that such a course would enhance the equity of the local tax system,in addition to providing substantial additional revenues. It estimates that if the City had such authority, applications of currently existing taxes to various operations would generate in excess of $5 million of revenues annually. The major areas of application of existing taxes are: (1) the one percent sales and use tax could be applied to certain operations; (2) the five percent utility user's tax could be applied; (3) appropriate portions of the Business Tax Ordinance could be applied to such operations as management of residential properties, activities as lessors of office buildings and other commercial buildings, sale of reclaimed automobiles and furniture, lending of money and miscellaneous other activities such as escrow services and trust activities.

<u>Revenue Sharing</u> - The Subcommittee considered the subject of revenue sharing as a source of additional revenues. It believes that of the various forms of revenue sharing in existence, State-City revenue sharing is the most realistic in terms of identifying long-term prospects for additional revenues. A workable State-City revenue sharing program has been in existence for some years now with respect to several revenue sources. Some of the above suggestions for additional revenues are based on that established relationship.

While Federal revenue sharing has generated very substantial additional revenues for the City recently, the Subcommittee believes that this is an <u>uncertain</u> source of revenue and, therefore, suggests that the City should <u>not</u> program into its operational budget any such revenues expected from the Federal Government. Actual revenues derived from this source should be treated as non-recurring and handled separately from the operational budget. Also, the Subcommittee suggests that, in view of the complexity and continually changing outlook regarding revenue sharing, the Mayor and/or City Council should establish a group (e.g., a subcommittee of the Finance Committee) to continuously monitor and study the trends and outlooks in this area of the City's revenues.

IV

REPORT OF THE SUBCOMMITTEE ON CITY EXPENDITURES

ERNST & ERNST
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LOS ANGELES 90071

WALTER F. BERAN
Partner

April 5, 1976

Mr. J. Howard Edgerton
Chairman of the Board
California Federal Savings
and Loan Association
5670 Wilshire Boulevard
Los Angeles, California 90036

Dear Howard:

Respectfully submitted is the enclosed report from the Subcommittee on City Expenditures.

We were pleased to participate in this effort. Hopefully, in some measure it will serve the City in its efforts to seek a meaningful future course.

We would be happy to assist in any way, to answer questions, to clarify concepts, or otherwise make the report useful to the City.

Sincerely,

Walter Beran

Copy to Members of the Ad Hoc
Committee on City Finances
Mr. Frederick G. Larkin, Jr.
Dean Dorothy W. Nelson
Mr. Verne Orr
Mr. Robert D. Selleck
Dr. Charles Z. Wilson

Mr. William R. McCarley

THE MAYOR'S SPECIAL COMMITTEE ON CITY FINANCE

REPORT OF THE SUBCOMMITTEE ON CITY EXPENDITURES

SUMMARY CONCLUSIONS AND RECOMMENDATIONS

The city government of Los Angeles proposes to spend close to one billion dollars in the coming fiscal year — two and a half million dollars a day for city outlays. Over $300 a year per person, more than 4 cents of every dollar of family income, is expected to be spent for city services. This is twice the amount that the city was spending five years ago.

But the economic base which supports these expenditures has not doubled in the past five years. Population in Los Angeles has remained stable; jobs have increased only slightly; family and business income has increased only 50% since 1970; and the growth in assessed value of business and residential property has been even slower.

The direction of these diverging trends — continuing growth in the demands for city services without a matching expansion of the resources needed to finance these demands — will determine the city's fiscal future. The manner that these trends are brought into balance, or the lack thereof, will significantly affect the economic vitality of our community and the well-being of its citizens.

Many of the forces which have brought about these diverging trends are not local, but nationwide in scope. While in many situations the capacity of a city government to counteract the cumulative effect of these forces is limited, this is not entirely the case for Los Angeles. Los Angeles is not yet in a crisis.

The city's economic base has a number of strong and dynamic features. The city government's fiscal structure and fiscal practices are comparatively sound. Public officials strive for highly professional management practices. All of these elements — and more — are needed to resolve the dilemma of the diverging trends.

This subcommittee has not sought to determine which specific policies would most effectively overcome the dilemma of the diverging trends. We have not tried to assess whether property taxes should be cut, if downtown should be redeveloped, if mass transit is needed, if expenditures for the public's safety should be raised or whether the city should assume greater responsibility for social programs. Rather we have examined the city's financial trends and expectations and have asked whether the current processes of city government are adequate for the task of developing the required fiscal policies, procedures, and management practices. We have concluded that they are not and, therefore, we make the following recommendations:

1. <u>The subcommittee believes that there is a need to clarify the kind of city our citizens want and what is feasible to achieve</u>.

If we do not know where we are going, then any road will get us there. This has characterized Los Angeles in the past, but diverging trends make it imprudent to continue in this fashion. It is the responsibility of the City Council to define new directions. Consideration of the spheres of responsibility for federal, state, and local governments as well as the private sector is needed to guide legislation. The council is, however, currently hampered by inadequate information, such as the uncertainty of economic trends and inflation,

population and personal income growth, business relocation, family size and residential mobility, shifting intergovernmental relationships, and the increasingly high costs associated with services. It is recommended that:

> (1) *A commission of citizens be established to undertake an intensive study of the economic, demographic, fiscal and governmental characteristics of Los Angeles and the potential problems which the city confronts.*
>
> (2) *Procedures be established within city government to develop five-year outlooks which are consistent with underlying economic, social and other trends and which will provide information to assist the annual budget process.*

2. <u>The subcommittee believes there is an urgent need to revise the processes as it relates to three categories of expenditures; employee compensation, social programs, and capital improvements</u>.

Labor costs account for almost three-fourths of budget outlays. Any attempt to constrain the escalation of city costs must allow for fair compensation and appropriate working environment for city employees. The meet and confer process should be strengthened to achieve this result. It is recommended that:

> (3) *The existing prevailing wage requirement of Section 425 of the city charter be eliminated and replaced by the meet and confer "total compensation" negotiation process to include consideration of not only wages and salaries, but all forms of employee benefits.*
>
> (4) *The city place an even higher priority on the introduction and development of appropriate productivity improvement and measurement programs, and that the mayor establish a board composed of city management, employee, and private sector representatives to develop recommended policies and approaches.*

Many of the city's social programs are funded through federal grants. This creates uncertainties with respect to their continued funding, indirect costs for the city, and reduced city discretion over their

future. This means that although these programs are a significant part of the expenditures, they are not a significant part of the budgeting and management process. It is of particular importance that these direct social programs be linked with other ongoing departmental programs for the achievement of common social objectives. It is recommended that:

> (5) *An interdepartmental agency be established (as previously proposed) to properly plan and coordinate all urban, community, and human resource development programs.*

Capital maintenance and improvements are vital to achieving high levels of productivity and an attractive environment for business and families. Yet in periods of inflation, slow economic growth and tight budgets, some needed capital and maintenance outlays are foregone or deferred. This often means higher capital outlays in later years and loss of potential economic activity to other areas as well as a basic physical deterioration. It is recommended that:

> (6) *The annual five-year capital outlay program be developed on a basis which more clearly identifies all needed capital improvements, defines their priorities, identifies deferred activities, and includes the estimated impact of inflation and construction cost changes.*

3. The subcommittee believes there is a need to more clearly delineate the responsibilities of the mayor and the City Council and to provide them with an adequate capability to meet these responsibilities.

It is recommended that:

> (7) *"An Ad Hoc Committee be appointed jointly by the Mayor and City Council to conduct an in depth organization study and make specific recommendations in order to clearly delineate executive and legislative responsibilities balances continue to exist."*

4. <u>The Subcommittee believes there is a need to strengthen the city's financial management.</u>

The city's financial decisions are arrived at through a system of checks and balances involving the mayor, council, elected controller, appointed treasurer, CAO, and departments. It is vital that these be continued while reducing some of the weaknesses in the process which have developed over time. It is recommended that:

> (8) *An independent city department of finance be established to be headed by a qualified finance director reporting to the mayor and responsible for revenue estimating, budget planning, financial management, accounting and reporting, and grant administration.*
>
> (9) *The charter be revised to eliminate the position of elected city controller, and require a full scope annual audit of the City.*

These recommendations are in agreement with the previously submitted (May 1975) recommendation contained in the Mayors' Ad Hoc Committee on Disbursement System-Security Procedures.

5. <u>The Subcommittee believes that public accountability is a major objective, and that adequate disclosure of financial information is an essential component of the government process.</u>

The government now requires extensive disclosure by private enterprise to the public, to government agencies, and to its shareholders. No less should be expected and demanded of public officials. It is recommended that:

> (10) *Clear and full public disclosure by initiated by city ordinance to disseminate city budget summaries, economic forecasts, financial outlooks, financial and independent audits, reports, and budget impacts of the meet and confer process.*

(11) *The budget information provided the City Council include readily understandable and gross budget information on the public services being provided the residents and businesses in the city in relation to needs, priorities, and financial resources.*

The subcommittee has based these recommendations on its analysis of the city's financial trends which are summarized in the following pages. Additional specific recommendations for the city's response to these major concerns are included.

INTRODUCTION

Scope of Subcommittee's Review

The scope of this subcommittee's review focused on the city's expenditures, expenditure trends, budget practices and procedures, as well as financial policies, systems, procedures, and controls. Because these activities are practically inseparable from the organization and management aspects, this review also focused on the changes necessary to better plan and manage the city's financial resources.

Excluded from our review is any evaluation as to the merit or adequacy of specific programs since this aspect is a policy issue and the subcommittee is not a proper forum for such an evaluation. However, since it was apparent that many of the fiscal problems encountered in New York resulted, at least partially, from poor fiscal management practices, our review focused on whether the city's current practices are conducive to proper fiscal policies, adequate budgetary and financial systems, procedures and controls, and sound organizational and management practices.

Finally, the subcommittee has dwelt at great length on the matters covered by this summary. It had the benefit of extensive consulting resources which were provided by its members as well as by UCLA, Bank of America, Security Pacific National Bank, Pacific Mutual Life Insurance Company, and Ernst & Ernst. As a consequence, the subcommittee has prepared a comprehensive report detailing the matter contained in this summary, as well as other issues, for the benefit

of the city. This comprehensive report is available to the city for its use.

The Basic Problem

Because of current revenue and expenditure trends, present program commitments, and a changing economic environment, the city faces very real, serious and continued budget deficits. The deficits require analysis, candid public disclosure, and dialogue by the mayor, the council, and the public to insure that steps are taken to alleviate the deficits yet assure these steps are in the long-term interest of the city. This process involves the recognition that expenditures are met by raising revenue from the economic community; accordingly, this economic base must be constantly appraised to insure its continued viability. In addition, the city must recognize its revenue source limitations -- it must not levy taxes which result in businesses and people relocating outside its boundaries, or make it less attractive for business and people to locate within its boundaries. Ultimately, revenue must be used to determine expenditure ceilings.

In addition to the general need for a realistic recognition of and approach to the city's potential financial crises, the processes of city government need the same immediate, critical attention.

Will Los Angeles Become an Aging City?

The City of Los Angeles is not in crisis; however, it is at a crossroad. It can become an "aging" city like New York, Detroit, St. Louis, or Chicago; or it can take a different road. The way the city goes

depends in part on what city government is able and willing to do.

Generally, the larger and more stable a city is, the higher will be its per capita cost for municipal services. Aging cities are large cities -- with over half a million people -- but not all large cities are aging. These aging cities have been losing population to their own suburbs and to other urban areas. They are not likely to attract new people, particularly those with sophisticated job skills, high levels of educational attainment, and expanding earnings potential.

Aging cities confront declining employment opportunities because job losses through business relocation are not replaced by new enterprises. Also, their economic base tends to consist of the nation's slow-growing rather than dynamic industries. The costs of doing business and costs of living are high in these cities not only because aging plants and equipment and deteriorating public facilities constrain the improvement of productivity, but also because costs of energy and labor tend to be high. All these factors make aging cities less attractive places for families and businesses to locate, but also make it difficult for them to annex, or consolidate with, higher income surrounding areas.

The outlays of municipal government are high in aging cities. This is partly because public as well as private sector productivity gains are difficult to achieve when facilities are becoming obsolete, crime and congestion are growing, and labor skills are not. But, also, municipal government costs are high because many municipal

services cannot be easily reduced, even though the city's population falls off and its revenue grows only slowly. This in turn means that the number of city employees relative to the population is high and, adding still more to municipal costs, city employee wages tend to be higher and retirement benefits more generous.

Aging cities spend more on capital improvements than do growing cities. Even though these cities do not require expanded public facilities to accommodate an increasing population, heavy expenditures for maintenance and replacement are needed. Aging cities are required to spend relatively more for capital improvements, not so much to catch up with the growing cities, but simply to avoid physical deterioration. This occurs under circumstances where the long-term debt and interest payments on this debt are already high.

In order to fund their higher expenditures, aging cities raise more in local taxes. Property tax rates and tax collections are higher, and these cities additionally tend to impose income or payroll taxes. Sales tax revenues, however, are lower (because of less business being transacted) even though tax rates are not.

Once the aging process begins for a city, it is difficult to reverse. This is because many of the forces which contribute to aging are not local but nationwide in scope. Interregional population shifts, suburban residential trends, reduced demands for specialized products, and increased production costs at particular places may all reinforce each other in molding the aging city. The capacity of a

city government to counteract the cumulative effect of these forces is limited. Increasing services in order to make the city more attractive also increases the cost of government which runs counter to making the city more attractive. Thus, for already aging cities the best policy may be to adapt to the aging process rather than to resist it.

Los Angeles, however, is not an already aging city. Los Angeles is not yet ready to grow old gracefully. It is ready for city government to develop those policies which would help to prevent aging and promote the city's economic vitality.

Organization of Report

The findings and conclusions are described in the following sections:

- Present Fiscal Health
- Future Financial Health
- Budgetary and Financial Management

The present fiscal health of the city is examined in relation to that of other major cities through comparison of recognized warning signs and ratios. These measures assist in assessing the city's strengths and the magnitude of any potential fiscal problems in conjunction with the environment in which major cities must operate.

The section encompassing future financial health assesses the city's overall health which it is likely to encounter because of revenue and expenditure trends, the underlying tax base and the changes which may occur in the city's economic environment. Potential problems are identified and related to the circumstances likely to exist.

The budgetary and financial management sections assess the city's current organization and practices with the principal focus on sound fiscal management practices. In addition, the potential problems inherent in the future financial health of the city have identified changes required to properly plan and manage these functions in the future.

Based on these findings and conclusions, the subcommittee sets forth in a final section recommendations with respect to a number of issues. These are presented and discussed in five categories:

- the management process
- the long-range financial planning process
- the budget process
- employee compensation issues
- financial policy issues

The management process sets forth suggestions regarding changes in the city's basic organization to more precisely correlate responsibility with authority, as well as changes in the staffing of the city's financial management function. These are designed to assure that the city's scarce financial resources are planned and managed on a sound and responsible basis in conformance with charter and legal requirements, and with the budget adopted by the council.

The long-range planning process describes the processes which would insure that adequate information, both economic and in the form of a financial outlook, is available for decisions currently affecting the city as well as three to five years hence.

The budget process focuses on those actions which should be taken by the city in order to improve existing budgetary and financial planning and management procedures.

The employee compensation issues cover the wide range of personnel programs and includes pension and retirement costs.

The financial policy issues relate to the broader issues of the city's role, primarily in relationship to other governments, in controlling expenditure levels.

Certain of the proposed changes will require appropriate charter amendment; others can be implemented by council ordinance or administrative action. Some involve sensitive issues as well as political considerations. Yet, we believe they are appropriate for consideration and adoption at this time when more decisive changes are called for.

THE PRESENT FISCAL HEALTH OF THE CITY OF LOS ANGELES

The present fiscal health of the City of Los Angeles is relatively sound when compared to that of other major cities.

In 1973 the Advisory Commission on Intergovernmental Relations (ACIR) issued a report which identified several "warning signs" to help cities determine potential fiscal problems. The commission stated that "the most important single factor in throwing a city into financial crisis is its inability to pay off short-term loans that accumulate over a period of several years."

From 1965-1975 the City of Los Angeles incurred no short-term debt. The city's "dry period," usually from July 1 to December 10, is financed internally from "unexpended bond funds" or the "reserve fund." Repayment of borrowings from such funds is senior to all other debt, and borrowings are repaid by December 10 from the tax revenues received by the city.

Another warning sign is a sudden substantial decline is assessed valuation. For the City of Los Angeles, gross assessed valuation has risen from 5.7 billion in 1965-66 to $9.5 billion in 1975-76. In fact, there has never been a year with diminished assessed valauation.

Another important warning sign is a negative cash balance in the operating fund. From 1965-1975 the City of Los Angeles has had a positive cash balance in the operating fund of no less than $35 million, which existed in 1966. For 1975, the positive cash balance was $64.5 million.

Another factor which has been significant in maintaining the sound fiscal health of the City of Los Angeles is the city's approach to debt service reduction, which is "equal principal payments" rather than the alternative "level debt service." The use of level debt service reduces the annual cost in the early years, but substantially increases the total interest costs which are deferred to the future. The other alternative, which the city follows, is equal principal payments which reduce interest payments. This latter method enables better matching of costs with benefits and increases the financial responsibility for capital investments.

Much comparative information on the larger U.S. cities for the years 1971 and 1974 was included in a presentation on the "Fiscal Health of Major Cities" by the District of Columbia Municipal Research Bureau before the Intergovernmental Relations and Human Resources subcommittee of the House Committee on Government Operations, on July 15, 1975. In the different comparisons with other major cities, Los Angeles has continually ranked among the highest with regard to the measures used to evaluate a city's fiscal health.

In a revenue-expenditure comparison of 30 major U.S. cities, Los Angeles had a deficiency of revenues compared to expenditures in 1971, as did half of the group compared. In 1974, Los Angeles had improved, not only to generating an excess of revenues as compared to expenditures, but to having the largest surplus, $40.7 million, of any of the 30 cities compared. Only 19 of the 30 cities had an available surplus in their general operating fund in both 1971 and

1974. Los Angeles was one of those cities and first in total amounts $115 million in 1971 and $160.3 million in 1974. Even when these figures are adjusted to eliminate transfers from the reserve fund, the city shows the ability to balance revenues and expenditures within reasonable limits.

However, while the city is currently (1975-76) operating under a "balanced" budget, a quick perusal of the budget will indicate that it is less balanced than it appears to be. The current budget is balanced in that estimated revenues are shown as equal to the same amount of estimated expenditures. As a practical matter, however, the budget is actually balanced through "reserve fund transfers" of approximately $40 million, plus carry forwards of available fund balances from the prior year of about $13 million. In addition, the budget reflects the fact that the city has elected to expend a larger portion of gas tax apportionmnets for maintenance than has been the practice in prior years, and yet the capital improvement expenditure program was reduced.

General obligation bonded indebtedness per capita is another important measure. The average for the City of Los Angeles was $331 in 1971 and $362 in 1974 — placing it twelfth in 1971 and tenth in 1974 in per capita bonded indebtedness. When debt is expressed as a percentage of value, Los Angeles improves to third position. Comparative per capita combined state and local overall debt information shows Los Angeles with $519 versus New York at $1,280 and San Francisco at $1,086, and a median of $623.

THE FUTURE FINANCIAL OUTLOOK

While the present fiscal health of the City of Los Angeles is sound, and while the mayor and the City Council are to be commended for taking the difficult, yet positive, action in meeting the challenge of the balanced budget in recent years, the stark, simple fact is that the city has come to a point where it faces major deficits with the attendant potential deterioration of municipal services.

Expectation of a Chronic Budget Deficit

Our concern is not new, for the CAO put the city on notice in a review of the city's financial outlook dated October 24, 1973. In his report to the council, the CAO stated:

> The perspective for the future is influenced by trends developed in the recent past. In recent years the City, finding revenues from existing sources insufficient to fund budget appropriations fully, has frequently budgeted Reserve Fund transfers and a revenue item entitled 'New Revenue Sources' to close the gap. *The chronic insufficiency of current revenues to meet increasing appropriations is due to the fact that appropriations have been increasing at a rate of about 11% per year compared to a natural growth rate in revenue yields of only about 4%.* (Italics added)

The CAO's report went on to say:

> We have projected appropriations on two alternative bases: (A) Assuming a continuation of the trends since 1968-69, and (B) assuming a lower set of appropriations, held 5% below the Alternative A number. On either basis, significant appropriation/revenue gaps (deficits) would develop in the absence of any significant windfall of new sources of revenue. These gaps would be in the general order of magnitude of the following amounts, the differences between the diverging trends of revenues and appropriations.

Alternative Revenue Gap Projection
(million dollars)

Fiscal Year	Present appropriation trend continues (Alternative A)	Appropriation trend is reduced by 5% (Alternative B)
1976-77	69	36
1977-78	111	74
1978-79	131	93

> In both instances the projections assume no new taxes nor increases in existing tax rates, and do not take into account Reserve Fund transfers which will serve to some degree to narrow the revenue gap...."a sharp departure from existing trends would be required in order for future budgets to be financed by foreseeable revenues."

In order to gain additional visibility, the subcommittee on expenditures made use of a number of analyses including a "Fiscal Outlook" model developed at UCLA which sketched out five possible scenarios for the city's future. As a result of these analyses, the subcommittee not only shares the concern expressed by the CAO, but believes the current potential budget deficits could be more severe than indicated in the CAO's report. *(The phrase, "budget deficits", has been used in lieu of "revenue gaps" in order to convey more clearly the need to better plan and control appropriations as well as revenues.)*

The City's Changing Economic Environment

The magnitude of the potential budget deficits will be influenced by the change in the city's economic base in terms of population, personal income, and assessed property values. During the decade of the 1960s, the city's population continued to grow following the post World War II trend for Southern California. By the 1970s however,

population in the city had stabilized even though state population has continued to grow. Partly because of the increased number of jobs and primarily because of increased business and labor productivity, family income in Los Angeles almost doubled over the decade of the 1960s. Income increased at the same pace during the first half of the 1970s, but a substantial part of this increase could be attributed to inflation. Assessed property values followed the personal income trends, but at a slower pace, increasing at about 75% of the rate of personal income growth.

Under all scenarios of the Fiscal Outlook model, the city's population is expected to be stable and its growth in personal income is projected to be lower than that of the county and state. Even if the city's population remains stable, personal income and property values will continue to grow -- somewhat slower at a moderate inflation rate, and somewhat faster at a continued high inflation rate; but much of the future growth in income and property values will result from inflation rather from new jobs, new firms, and productivity gains. After adjusting for inflation, the "real" growth in personal income for the city is likely to be between 2.5% and 3% per year -- a modest rate when compared to past standards. However, if a number of businesses in the city choose to relocate, while other businesses fail to perceive Los Angeles as an attractive place, then the "real" personal income is likely to remain stable as long-term productivity gains will be wiped out by the loss of jobs and business. The impact of a slowing growth of the economic base and ultimately city revenues could be alarming.

The long-range implications of the diverging trends between revenue and expenditures on the city and its ability to support needed programs through current revenue sources are substantial.

Revenue Limitations in Supporting City Services

The city's revenues have more than tripled since 1960. About one-third of this increase came from increased tax rates, another third can be attributed to growth in the city's personal income and property value, and the final third from increases in federal and state financial assistance.

Increasing property tax levies have accounted for one quarter of the city's increased revenues. Almost all of this increase has gone for city retirement and pension purposes, rather than to support general government.

The general government tax rate is the property tax rate to support general government (does not include pensions, retirement, debt service). The 1975-76 budget necessitated that this rate be increased near the maximum rate of $1.41. Since this is close to a maximum, the rate cannot increase appreciably except for increases in population, consumer price index, and assessed valuation. Based on past increases, general government revenues will increase only 3½% to 4½% per year. Since this source of revenue currently supports 30% of general government expenditures but is expected to grow only by 4% in the future, this means that other sources of revenue must grow even faster in order to keep pace with the average 11% growth of expenditures.

Returned sales taxes and various forms of state assistance currently account for one-quarter of the city's revenues. If the economic vitality of Los Angeles is maintained, these revenues could provide a source of support for growing expenditures. However, it is unlikely this source will be able to offset the reduced revenues induced by a relatively stable general property tax rate. Further, if the city's economic position deteriorates, these revenues will become less capable of supporting growing expenditures.

Subventions and grants have been increasing substantially in recent years and are now over one-tenth of total revenues. However, a majority of these are for mandated purposes, often for capital or social programs which restrict city management in decisions regarding operations. Although such revenues may increase, they are not likely to be able to support the continued increase in city government general expenditures.

Thus, the city must turn to its own nonproperty revenue sources if growing city government activities are to be funded. These sources are primarily general business taxes and a variety of licenses, permits, fees, and fines. Together they currently account for more than one-third of city revenues and have been a major source for past revenue increases. In 1960 these revenues comprised 80 cents of every $100 of personal income in Los Angeles, and by 1975 they had reached twice this rate. Business taxes alone have increased at an average of over 14% per year over the last four years. If growth in the city's economic base were to pick up, then these

revenue sources could support a large part of the growing city expenditures without increasing the tax burden.

However, the most probable expectation is that substantial economic growth is not likely. Slow economic growth will require increasing the tax burden to support growing city expenditures; relative economic deterioration would compel even greater increases in the tax burden. And, as the tax burden increases, there is likely to be an additional exodus of business, employment, and families from the city. Thus, the city is caught between the need and demand for increased services on the one hand, and increased tax burdens with the attendant potential loss of the city's tax base on the other hand. Treading the line between these alternative courses of action requires courage, wisdom, and a relevant basis of information.

Even though the city's tax burden (i.e., city-raised revenues in relation to the economic base) is only one-fifth of the burden imposed on Los Angeles citizens and businesses by the state and local governments, it has grown by about 20% in the past decade. The subcommittee believes that further increases at this pace threaten the long-run economic vitality of the city, thus the need to critically review all expenditures.

City Expenditures

City expenditures have more than tripled since 1960 with over half of this increase occurring during the last five years when inflation caused considerable addition to the city's expenditures. Since city population increased only slightly between 1960 and 1970 and

thereafter has remained stable, per capita city expenditures have also tripled over the past fifteen years. As compared with $85 in 1960, the city government now spends $275 per person. Not only is the city spending more per person, but also it is spending more in relation to the economic base in the community. Currently, the city is spending over $4.00 for every $100 of personal income earned in the community, as compared with $3.40 in 1970 and less than $2.00 in 1960. The increase in the city expenditure share of personal income since 1970 has been at twice the pace of the preceding decade, suggesting that the rising rate of inflation has caused a more rapid increase in city costs than in the city tax base.

There are now about 28 thousand city employees, two-fifths of whom are police officers and fire fighters. Employment has increased by 8.5 thousand persons since 1960, and half of this increase took place since 1970. The police department has accounted for 70% of the added employees since 1970, while general management (partly because of the federal emergency employment programs) accounted for the remainder. Both civilian and sworn employment have increased by 40% since 1960 and 20% since 1970. The city employment has increased from 7.8 persons per thousand population in 1960, to 8.4 in 1970 and 10 in 1975.

Employee Compensation and Related Benefits

Labor costs are the major cost of city expenditures, with salaries and retirement representing approximately 70% of the city's budget. While it appears that labor costs as a

share of the total budget have been increasing, the increase is primarily due to the growth in pension and retirement costs. The increasing impact of pension and retirement costs is apparent in the following summary:

(In millions)

1966	1970	1975		Current growth rate
35.6	63.4	120.3	Property tax levy for Pension & Retirement	12%
120.6	171.1	251.6	Total property tax levy	7%

The important observation is that pension and retirement costs have been increasing at a substantial rate. Ten years ago they were just half of the total property taxes for general municipal government (which in itself has been increasing), and now they are greater. These expenditures will grow even higher because of likely increased growth rate. Since pension and retirement expenditures are becoming a major part of the total property tax levy, and since this levy is not subject to any limitation (as with that of general government), the total property tax levy will tend, in time, to approach the growth rate of pension and retirement costs.

A contributing factor to the increased pensions and retirement costs is the incidence of disability retirements. Disability retirements in the period 1969-1974 averaged 45 per year in the Fire and Police Plan and the New System combined. In 1975 disability retirements were at the rate of approximately 90 per year. The present value of each disability pension at the

time of retirement is estimated to range from $100,000 to $250,000. The number of disabilities in the city employee retirement system has also increased. The cause of these increases is not clear although it has been stated that recent court decisions have had an impact.

The pension and retirement expenditure, in conjunction with compensation and other personnel benefits costs is critical in any serious attempt to manage the budget. A thorough understanding of how city employment, wages, fringe benefits, and retirement costs affect budget expenditures and service quality over the long run is required. It is also necessary to know the influence which other factors, such as inflation, private sector wages, and productivity improvements will have on labor costs. New arrangements for labor management negotiations are now being forged which will affect future labor costs. Anticipated continued inflation will boost labor demands to cover rising living costs. Productivity improvements have the potential for constraining cost increases but are not always easy to identify or introduce.

Capital Expenditures

As indicated, the city has elected in the current budget to expend a larger portion of gas tax apportionment for maintenance than has been the practice in prior years. While permissible, such a shift really constitutes a reduction of revenues normally applied to capital expenditures, and masks budget deficits.

For the same reason, projects may have been deferred. Not only do such arrangements represent a shift in period costs, with a possible significant impact on the city's financial health, but deferred maintenance and deferred capital programs portend a deterioration which runs counter to responsible government. Neither is such deferment without the attendant increasing cost of inflation.

In recent years, the city has also entered into certain "leaseback" and "joint powers" agreements. Under certain circumstances, these are sound and practical means of constructing capital improvements, especially where more than one governmental jurisdiction is involved. However, such methods of financing capital improvements could result in a significant present or future financial liability and/or impose significant demands on general fund revenues without identifying how such supporting revenues are to be generated. These methods of financing capital improvements, in practice, avoid the legal and other constraints inherent in established city budgeting and financial practices.

The city's 5-year capital program for physical plant and municipal facilities projects totals approximately $1.5 billion, of which the city's proposed share is about $1 billion. In addition, other projects are scheduled, totaling approximately $493 million. No provision is made in the plan for future inflation. It is also probable that certain of the estimated

costs shown in the plan are understated. For example, sewers estimated to cost approximately $438 million six months later was revised upward to $500 million; and this may not reflect all costs which will be incurred to meet federal and state requirements. A need exists, therefore, not only to reflect inflationary and other probable cost increases or decreases in the long-range plan, but also a system more clearly identifying priorities based on comparative need and ability to finance.

A substantial increase in the general obligation bond debt as a financing alternative could pose some practical problems. What effect, for example, would the increase have on the city's bond rating and consequently on the interest paid? Would the increase in noncontrollable expenditures (partially interest) adversly affect the city's rating and interest? Can, in fact, the city service the bonds without initiating new taxes which, in turn, could have an adverse effect on the city's economic structure?

The potential impact of federal requirements cannot be overlooked in developing the capital plan. Certain federal/state programs now impose, or may impose in the future, a significant financial burden relating to capital improvements which must be met by the city, notwithstanding significant federal/state assistance. This is particularly true with respect to federal environmental and other requirements for which users or beneficiaries cannot be expected to pay all the costs of the improvements.

Federal Grant Program

Cash receipts from federal grants have increased from less than $10 million in 1969-70 to an estimated $150 million in 1975-76, exclusive of proprietary departments, certain other agencies, and general revenue sharing. For the fiscal year 1975-76, federal and state grants for all city functions, exclusive of general revenue sharing, aggregated over $200 million. In addition, the 1975-76 budget identifies approximately $41 million of general revenue sharing funds. Total federal and state revenues, therefore, included in the 1975-76 budget aggregate about $250 million, an extremely significant portion of total projected revenue.

A number of significant present and potential problems exist with respect to grant programs. For example:

- Uncertainties exist regarding the level of federal funding which can be anticipated.
- Grant programs involve many hidden costs or potential costs which are not readily discernible.
- Grant programs may impose unrealistic requirements or priorities.

However, grants continue to be a viable means to pursue important social programs in conjunction with the city's overall priorities and goals.

City Sponsored Social Programs

Recently, the city has sponsored programs which are not now mandated by federal or state governments. An example, although

the financial impact is small, is the utility user's tax exemption which is granted to all owners or renters over age 62 who have an income of $7,500 or less. "Lifeline" utility rates is another program wherein a minimum rate is charged to users who meet specific age and income requirements. In each case, services provided a particular category of users or beneficiaries are subsidized through the rates or fees charged other users, or through general fund revenues. Significant entry of the City of Los Angeles into such locally subsidized programs could impose unknown, but potentially significant, future financial liabilities.

BUDGETARY AND FINANCIAL MANAGEMENT

The subcommittee's review was not developed from the traditional perspective of simplifying, strengthening, or improving budgetary and financial systems, procedures, and controls. Rather, it was apparent that many of the fiscal problems encountered in New York resulted, at least partially, from poorly defined or improper fiscal policies, inadequate budgetary and financial systems, procedures and controls, and the failure to manage the city's resources in conformance with sound management practices.

Findings and conclusions are set forth in four areas: financial policy issues; the management process; the budget process; and the long-range financial planning process. The various functions performed within these areas bears heavily on both the current and future financial health of the city.

A number of specific financial policy issues were identified during the study which are deemed to be significant from the perspective of establishing realistic controls over expenditures; providing accurate and timely information concerning the city's financial situation; and to clarify or establish policies which may be significant in helping to maintain the city's future financial health. In many cases it was difficult to ascertain the existence of set policies; for example, the use of the reserve fund as a means of continually balancing the current budget in satisfying the charter requirement of a balanced budget. This would be especially critical

if the remaining balance in the reserve fund is not sufficient to cover contingencies. An additional area is reimbursement to the city by independent departments for special services and "lieu of taxes" payments.

In the area of the budget process, the present budget document is bulky, complex, and very difficult to understand, especially from the standpoint of the public. Nowhere is the budget summarized and explained from a perspective of a proposed financial plan. Rather, it is developed and presented in "traditional" line-item appropriation format by agency and department and really comprises a proposed appropriations document for the council to consider and act on.

The city also prepares a supplemental program budget which sets forth by department and program area the specific public services to be provided during the fiscal year together with the proposed level of services and the estimated costs thereof. The program budget is primarily a management resource at the departmental level. However, it could be of valuable assistance to the council in its hearings to the public in defining public services to be provided if its format and content were understandable and could be related to the line-item budget. This is not the case, however; while the program budget contains much valuable information, both budget documents are equally difficult to understand or to use as a resource to explain to interested third parties and the public what the city proposes to accomplish.

There is a need for a relatively short, easy-to-understand, summary document which describes the services to be provided by the city, summarizes the budget, and identifies the way the city proposes to finance its operations. This document could also alleviate the present void of very little information being disseminated to the public.

The city's financial management function is presently performed by many persons. The CAO advises the mayor and the City Council on the condition, finances, and the future needs of the city and provides direct assistance to the mayor and council in preparation of the annual budget, in administration of the budget, and managing the various public service programs. He is also responsible for a number of other specific duties and responsibilities involving city finances.

The city controller serves as the chief accounting and auditing official and exercises general supervision over all appropriation accounting. He also is responsible for certain audit activities, for prescribing uniform accounting and reporting procedures, as well as for preparing revenue estimated for budgetary purposes. It is interesting to note that his accounting records are maintained on the basis of twelve fiscal periods per year, while the budgetary controls established by the CAO at the departmental level require departments and agencies to report and account for expenditures by line-item and program on the basis of thirteen fiscal periods per year.

The city treasurer, an appointed official, manages the city's investment portfolio as well as other charter defined functions. Administration of many federal revenues -- an important factor in financing and managing many city programs -- is vested in an organizational unit (Bureau of Grant Administration or BGA) reporting directly to council.

Responsibilities for financial planning, management, and control are fragmented between the CAO, the elected controller, treasurer, City Council, and the operating departments. This dispersion of financial management organization and responsibilities makes it extremely difficult for the city to properly plan, manage, and coordinate its financial resources on a day-to-day basis in conformance with what would be considered sound financial management practices in many other governmental agencies or most commercial or industrial enterprises.

While the present system of checks and balances has resulted in fiscal stability and conservatism in the City of Los Angeles, certain organizational and system changes must be made in order to enable the city to properly plan and manage its finances and exercise proper budgetary and expenditure control. These changes are critical at this time because of increasing costs and inflation, expected budget deficits, and because of the city's changing economic environment.

RECOMMENDATIONS

The Management Process

- The lines of authority among the mayor, City Council, city administrative officer (CAO), and department heads should be more clearly delineated and the range of responsibilities more realistically specified.

  An Ad Hoc Committee should be jointly appointed by the Mayor and City Council to clarify authority and responsibility as it is extremely difficult for the City to either plan or manage its financial resources on a day-to-day basis in conformance with what would be considered sound financial and/or management practices in many other governmental agencies, or for most commercial or industrial enterprises. This is evidenced by the fact that the City's present organizational structure is highly fragmented since the City is presently organized into approximately thirty-one departments and offices of which twelve departments are under the control and management of a manager appointed by the Mayor subject to confirmation by the Council. In addition, several major City departments--the Airports, Department of Water and Power, and the Harbor Department-- have been established by Charter as independent or proprietary departments.

- Centralize all significant city financial planning and management functions in a unified city department of finance responsible to the CAO, to be headed up by a qualified finance director appointed by and reporting directly to the mayor.

The unified Department of Finance should be given, but not necessarily be limited to, responsibility for the following specific functions:

- Revenue estimating
- Budgetary planning
- Budgetary and financial management
- Budgetary and financial accounting
- Grant administration
- Establishment of uniform accounting and financial management and reporting policies, procedures, guidelines, etc.

• Transfer the grant administration, reporting, and monitoring functions to the Department of Finance. In addition, it is recommended that the city:

  - Develop uniform policies governing grant administration and monitoring, to include procedures to be followed to lessen the city's potential liability and impact of changes imposed by the federal government involving program content, level of support, etc.

  - Develop uniform grant administration, accounting, reporting, and monitoring procedures to be used for all grant programs which will provide required information concerning grant status, problems, etc., to the mayor, council, and departments.

  - Develop improved grant evaluation criteria, systems, and procedures, and require inclusion of appropriate cost/benefit and program data analysis in all submissions to council.

- Establish interim procedures, pending creation of the proposed unified Department of Finance and the concurrent transfer to that agency of all grant administration and management, for eliminating present duplication of effort or overlapping of responsibilities between the BGA, CLA, and CAO, and for properly preparing and/or coordinating grant applications.

- Eliminate the position of elected city controller, and transfer his accounting and related responsibilities to the new Department of Finance. The controller's audit responsibilities would be vested in the City Administrative Officer. No change is proposed with respect to the duties and responsibilities of the city treasurer, who is responsible primarily for investing and managing the city's portfolio and for debt management.

  - In its report issued in May, 1975, the mayor's ad hoc committee on the city's disbursement system-security procedures urged the creation of a unified Department of Finance headed by a qualified finance director as necessary to provide and maintain an adequate level of both internal control and fiscal accountability. This report further recommended the elimination of the elective position of city controller.

- Transfer the responsibility for planning and coordination of all city urban, community, and human resource development Bloc Grant programs to a single city agency.

This recommendation (as previously proposed) is intended to provide the city with the organizational and operational framework required to properly plan and coordinate activities on a uniform basis, consistent with city priorities and applicable federal and state regulations.

- Transfer all sewerage functions now provided by the Bureaus of Engineering and Sanitation, Department of Public Works, and other directly related support functions to a new agency. This agency should be established as an "enterprise" and its finances planned, managed, and controlled in conformance with the criteria recommended by the Municipal Finance Officers Association (MFOA) regarding enterprises. An enterprise is a self-supporting governmental activity which has many of the characteristics of a commercial or business enterprise and where services are rendered to the public on a user charge basis.

This proposal is recommended, not as a means of effecting internal reorganization, but to provide a basis for better planning and controlling a major city program, even though such an enterprise may continue to function as an organizational element of the Department of Public Works.

Consideration should also be given to the feasibility of establishing the Bureau of Sanitation as an enterprise within the Department of Public Works on a comparable basis.

The Long-Range Planning Process:

- The city should initiate procedures for conducting an objective assessment of the city's financial, economic, and demographic outlook on a continuing basis, to include:

  - Preparation, for submission to the mayor and City Council, of a five-year forecast of economic and demographic characteristics of the city, including, but not limited to, estimating personal income, population, property value, and employment.

  - Analysis of the potential impact of economic and demographic changes which might have a significant effect on the city's economic forecast due to situations arising from private industry and the resulting need for city services.

  - Development of a long-range financial outlook based upon the five-year economic forecast and recent revenue and appropriation trends for the present level of services.

    - Development of alternatives, for council consideration, to alleviate any forecasted "budget deficits." Such alternatives should include but not be limited to:

      - reduced services
      - new revenue sources
      - increased productivity

    - Communication of the economic forecast, financial outlook, financial alternatives, and audited financial reports to the public through wide circulation in conjunction with distribution to city management.

    - Incorporation of the foregoing data and information into the city budget deliberations.

- The present five-year capital outlay program document and procedures should be developed on a basis which better reflects all "needed" capital improvements, irrespective of whether such improvements are proposed to be financed in part or in total during the five-year period.

  - A system of priorities for use in future capital outlay planning and for determining the specific projects to be included in the budget for a fiscal year. These priorities should reflect both comparative need and ability to secure required financing.

  - The estimated impact of inflation and/or changes in construction costs.

The Budget Process:

- The principal focus of the budgetary planning process must be shifted from line items to the public services provided residents of the city in relation to needs, priorities, and financial resources. It is unrealistic to expect that the council will understand or use program and workload information (such as is set forth in the supplemental program budget) unless such changes are introduced into the process and in the focus and context of the basic budget document. It should be recognized that implementation of this is not a simple undertaking, as changes will be required in the city's uniform classification of accounts and coding structure and, undoubtedly, in certain of the city-wide systems and procedures which provide data input for budgetary planning, management, and control purposes, e.g., payroll, requisitioning, and purchasing.

- A supplemental budget summary (preferably not more than 25 pages) should be developed for inclusion in the City's budget document and for distribution to all interested parties in order to facilitate understanding which clearly presents the City's proposed financial plan (budget), explains changes over the prior fiscal year, and how it is proposed to finance City operations. This information can be developed to supplement the existing budget document without making any immediate changes in its format and content.
It is proposed that this information be presented in a "Budget Summary" which includes:
    - An appropriate summary with illustrations and narrative of projected revenues by source and expenditures by type of expenditure.
    - A proposed financial plan which shows budgeted revenues and expenditures in a way that is more understandable to the council and all other interested parties, and which also identifies how any deficits are to be financed.
    - A brief narrative explanation of the assumptions underlying the proposed financial plan (budget); major changes in projected revenues; new, expanded, or reduced levels of service (programs); and any other information required to understand the proposed plan.

Employee Compensation Issues:

- It is recommended that the city develop a uniform, integrated approach for compensating city employees which gives due consideration to all factors involved, including salaries and wages, pension and retirement benefits, other fringe benefits, and productivity. Specifically, it is proposed that:

- The city adopt a "total compensation" approach in negotiations with employee groups. "Total compensation" will include not just wages and salaries but also pension and retirement benefits and all other employee benefits or forms of remuneration.

  This will require elimination of the existing "prevailing wage" requirement of Section 425 of the city charter and substitute in its place compensation negotiations based on the present "meet and confer" process comparable to those followed by the private sector.

  Revisions will also be required in the comparative salary survey to provide comparative data concerning all employee benefits. This survey should be completed by an independent agency and employee organizations should participate in advance regarding establishing survey criteria.

- In compensation negotiations, proper consideration should be given to employee productivity. This will require that the city place high priority on the development and introduction of appropriate productivity measurement and improvement programs in city government.

  It is proposed that the mayor establish a board or commission comprising city management, employee, and private sector representatives to develop recommended policies and approach.

- Action be initiated to improve the city's public relations and communication program so as to properly inform city residents of the magnitude and impact of present "prevailing wage" requirements on the city's budget; on tax levels and revenue requirements; the need to control employee compensation and related costs within realistic limits; and the practical problems inherent in the present "meet and confer" process, and the role of the Employee Relations Board.

- Accomplish the following changes in city pension/retirement plans to better ensure their soundness and proper administration:
  - Establish appropriate policies for use in negotiating with the employee groups the sharing of the pension plan costs between the city and the employees.

  - Use the services of qualified actuaries in "meet and confer" sessions to determine the cost of proposed changes, not only for the first year, but projected over a period of years, before either compensation or benefit packages are agreed upon.
  - Impose maximum limits on the rate of annual cost-of-living increases for future entrants into the fire and police retirement plan by use of a fixed percentage (such as the 3% limit in the City Employees Retirement System) or an index which might relate to the resources available to cover the costs, such as the rate of increase of assessed property value.

- Develop actuarial cost calculations which include projections based upon reasonable assumptions consistent with some future level of inflation. Such projections should be viewed in the overall context of the city's budget, resources, and the economic environment.

Financial Policy Issues

- A study of the city's revenue structure should be jointly conducted by the CAO and CLA to determine the extent to which it is practical and desirable to eliminate dedicated or "earmarked" revenues, and to recommend necessary charter, legislative, or administrative change.

- Uniform financial policies should be developed and applied on an equal and consistent basis to the three independent (or proprietary) departments: the Department of Water and Power, the Department of Airports, and the Harbor Department, regarding:
  - Reimbursement to the city by all three departments for the "special services" provided each department.

  - Repayment to the city for the costs of capital outlays for the three departments financed and serviced out of city revenues.
  - Revenue transfer to be made as payments "in lieu of taxes" by all three departments, following uniform methods of determining appropriate payment levels.

- The council should assume leadership in assessing the role of city government in relationship to that of other governments, locally as well as at state and national levels. This applies to revenue as well as to program areas.

- The use of the reserve fund should be clarified. Basically, it should be used to finance contingencies -- not to balance the budget unless, in the opinion of the mayor and City Council, the revenue slump is temporary and will be returned to normal the following year. If the reserve fund is used for budget balancing, such use should be clearly and explicitly disclosed in the budget.